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An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

Securities Industry Association
120 Broadway
New York, New York 10271

Phone (212) 608 · 1500

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UPDATE ON
FOREIGN ACTIVITY IN U.S. EQUITIES

Third-Quarter Activity

Key variables in the foreign investors' decision to invest in U.S. equities are the relative strengths of the U.S. dollar and the U.S. stock market. At times, these two variables may be on divergent courses and the strength of one will outweigh weakness in the other. This was obviously the case in the first half of 1987. A robust stock market drew foreign funds into U.S. equities at a record pace, offsetting considerations of the beleaguered dollar. Although enthusiasm lessened moderately from the first to second quarter, foreign net purchases of $18.4 billion in the first half of 1987 were only a shade below full-year 1986's record $18.7 billion.

The third quarter proved a mixed bag for foreign investment in U.S. equities. The stock market was on a two-month roll through July and August, with the Dow reaching its peak for the year in late August. The dollar held relatively stable through July, actually appreciating against the major currencies. However, although the market went on to glorious highs in August, the dollar resumed a downward course.

Concern over the continuing fall of the dollar and escalating fears of inflationary pressures made for volatile U.S. stock and bond markets in September. The Federal Reserve raised its discount rate to 6% from 5 1/2% early in the month, with the main intent to quell inflationary expectations in the bond markets but with the side effect of aiding the dollar's position in the foreign exchange market. By month-end, although the dollar had firmed, the stock market had given up over 66 points and yields on some long-term bonds were at their highest level in two years.

FOREIGN ACTIVITY IN U.S. EQUITIES
($ Millions)

	Second Quarter 1987		Third Quarter 1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$53,854	$3,174	$63,540	$2,103
Belgium-Luxembourg	3,048	130	3,209	123
France	4,133	562	5,366	(17)
Germany	3,786	(138)	4,742	(80)
Netherlands	2,995	476	3,325	367
Switzerland	13,551	451	16,814	30
United Kingdom	24,133	1,527	27,295	1,524
Canada	12,482	62	14,103	189
Latin America & Caribbean	10,956	660	11,932	732
Bermuda	2,520	(36)	2,628	229
Netherlands Antilles	3,344	(2)	3,452	41
Asia	29,254	4,390	44,649	1,669
Hong Kong	3,063	173	3,093	359
Japan	20,348	4,098	34,613	1,923
"Other Asia"*	4,152	(95)	4,743	(1,034)
Total All Countries	**$109,388**	**$8,592**	**$136,760**	**$5,016**

Source: U.S. Treasury
* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

Foreign net purchases of U.S. equities moderated in the third quarter from the record levels of the first two quarters of 1987. Much of the third-quarter slowdown in net acquisition of equities occurred in August, when foreign investors' net purchases plunged to $220 million. It appears that intensified concern over the plight of the dollar overshadowed the rising stock market, as foreign investors' confidence in U.S. equities returned in September when the dollar's slide was temporarily halted. Hence, although not quite on par with the heightened investment level of the first half of the year, foreign net purchases in the third quarter came in at a still-impressive $5.0 billion. For the first three quarters of 1987, foreign investors added a record $23.5 billion of U.S. equities to their portfolios, surpassing 1986's full-year record of $18.7 billion by 25.6%.

Although net purchases dropped in the third quarter, gross transactions rose to a furious clip of $136.8 billion in the third quarter. At $359.2 billion for the first nine months of the year, foreign gross transactions are also some 29% ahead of the 1986 record $277.5 billion. Annualization plus October's preliminary figure would place foreign activity in U.S. equities at over $400.0 billion in 1987.

October...A Surprise

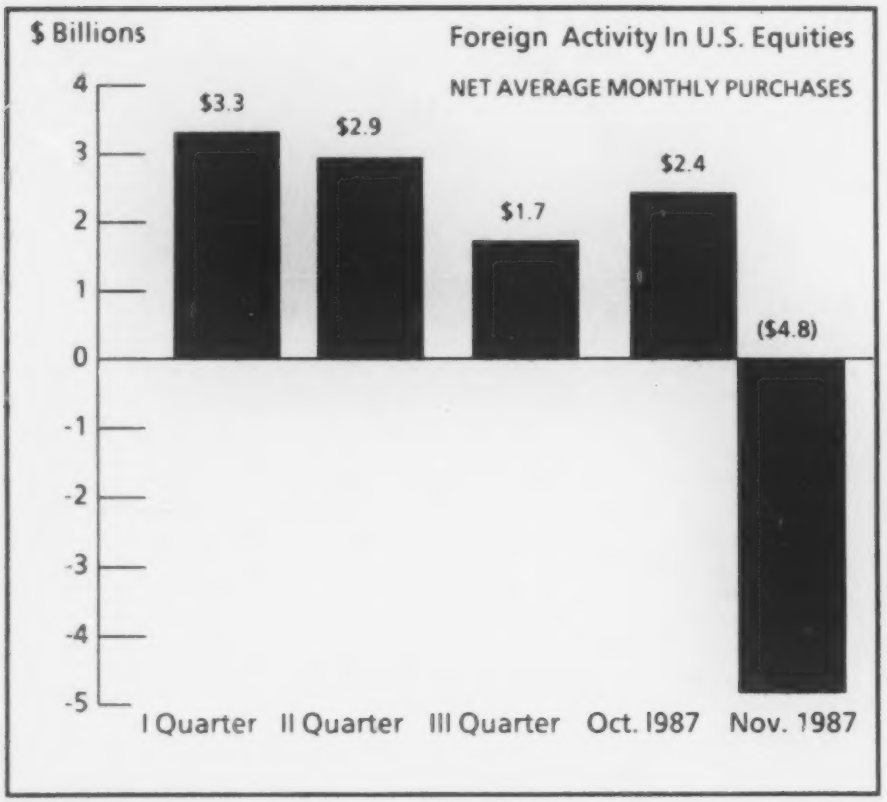
The worries that depressed September's market intensified in early October, cumulating with the market crash on October 19th. Although the market recovered in hectic trading over the remainder of the month, the Dow fell short of the 2,000 mark at October's close. As the Federal Reserve flooded the system with reserves and major banks lowered their prime rate in immediate response to the crash, the dollar once again became vulnerable to downward pressure. By the end of October, major currencies had taken comparably hefty strides ranging from 5% to over 7% vis-a-vis the dollar.

Contrary to speculation indicating net sales of U.S. equities by foreign investors, Treasury's data indicate that foreign investors were not massive net sellers in October. In fact, although caution should be used as the data are very preliminary, foreign investors were still positive on U.S. equity investment in October, making net purchases of $2.4 billion. Along with U.S. investors, foreign investors helped to push U.S. markets to unprecedented volume levels. Preliminary Treasury data puts foreign gross activity at $58.0 billion, compared with a third-quarter average monthly pace of $45.6 billion.

November...A Different Story

However, SIA preliminary and confidential data paints a different picture for November. With policy statements indicating government's emphasis on avoiding a recession at the risk of a lower dollar early in the month, the dollar went reeling through a series of historic lows. Major foreign currencies scored monthly gains of 5% to 7% against the dollar. At the same time, the market waited nervously for word of the budget agreement. Disappointment with the final details of the agreement coupled with the plight of the dollar sent the market on a 77-point tailspin on the last day of the month, leaving the Dow some 160 points down from October's close.

The sagging stock market and a seemingly abandoned dollar prompted foreign investors to shift to a negative investment posture toward U.S. equities. SIA preliminary and confidential data point to significant divestitures of equities by foreign investors in November, with estimates of net sales falling in a range of $4.0 billion to $5.5 billion.



December...The Deciding Factor

Unless November's preliminary number proves only a fluke and foreign investors returned to a positive position on U.S. equity investment in December, the fourth quarter of 1987 could well prove the first one that foreign investors were not positive on U.S. equity investment since the first quarter of 1985.

Carolyn Hildebrandt
Assistant Vice President

SIA

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FOREIGN ACTIVITY IN U.S. SECURITIES

"Highlights"

1. Foreign net purchases of U.S. equities in the third quarter slid 42% to $5.0 billion from $8.6 billion in the second quarter. Although activity dropped, foreign net purchases of U.S. equities came to a stunning $23.5 billion in the first three quarters of 1987, surpassing 1986's record $18.7 billion by 26%.

2. Foreign investors did not desert U.S. equities in October, with preliminary Treasury data placing net purchases at $2.4 billion. However, SIA confidential and preliminary data show large foreign divestitures, $4.0 to $5.5 billion, in November. Unless preliminary data is widely off the mark and/or foreign investors have a sudden change of sentiment in December, the final quarter of 1987 could be the first with net sales of U.S. equities by foreign investors since early 1985.

3. Foreign gross activity in U.S. equities rose at a furious clip to a high $136.8 billion in the third quarter. While not likely to hit the $500.0 billion mark, gross transactions in 1987 will be well over $400.0 billion, compared with the previous record of $277.5 billion in 1986.

4. From the second to third quarter, foreign investors' acquisition of corporate bonds was little changed, around $6.6 billion.

5. The dollar generally benefitted from more favorable than unfavorable news in the third quarter. Hence, foreign net purchases of Treasuries, which to a large extent reflects coordinated central bank intervention in currency markets, subsided to $2.8 billion from $8.6 billion in the second quarter.

6. A moderated approach to European and Canadian stocks, coupled with continued large sales of Japanese stocks, resulted in net sales of $66 million of foreign stocks by U.S. investors in the third quarter. This compares to net purchases of $705 million in the second quarter.

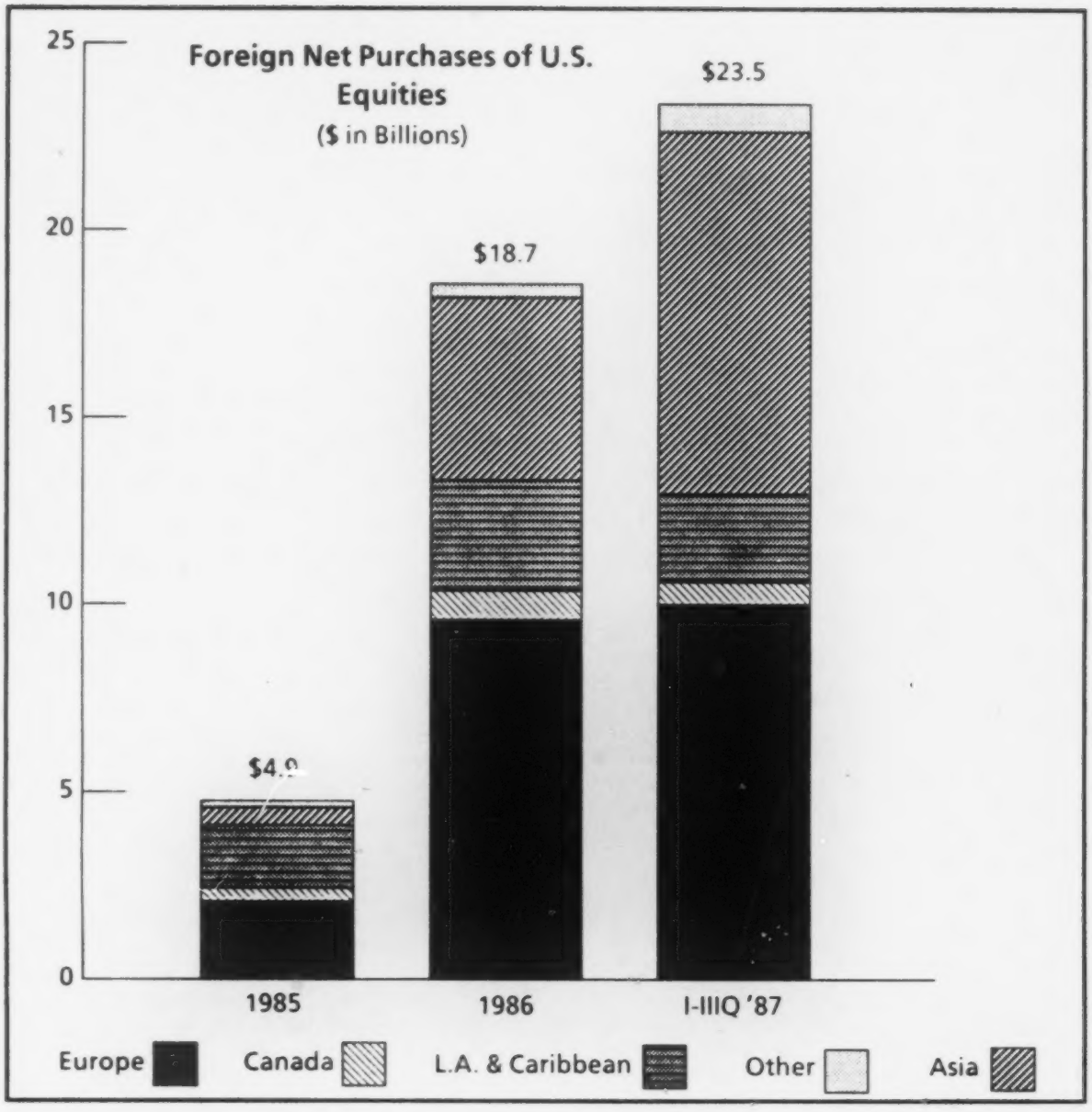
Overview

Foreign investment in U.S. equities soared in the first half of 1987 paralleling the soaring U.S. stock market. The downward route of the dollar was largely overshadowed in the euphoria of the market's climb. Indeed, the depreciating dollar was viewed as making U.S. stocks "cheap" in comparison to European stocks. Foreign net acquisition of U.S. equities hit $18.5 billion by the end of June, almost catching up with the record $18.7 billion for all of 1986. Nevertheless, from the first to second quarter, foreign investment in U.S. equities ebbed, given less steam in the market and dollar stability.

Foreign investors' activity in the third quarter showed that, while apparently "forgotten" in the first half of the year, the dollar is a key factor in the decision to invest in U.S. equities. Foreign net purchases slid 42% to $5.0 billion from $8.6 billion in the second quarter. However, although activity is sliding, foreign net purchases of U.S. equities came to a stunning $23.5 billion in the first three quarters of the year, with third-quarter net purchases alone more than total net purchases just two years earlier.

The third quarter saw the start of a two-month stock market roll which brought it to a lofty peak in August. The dollar, boosted by the "safe haven" concept, was extending its spring rally until deterioration in the U.S. trade deficit sent it plummeting. Although other factors certainly came into play, it appears that August was the first month in 1987 that foreign investors' consideration of the plight of the dollar outweighed the rising stock market. Net purchases of U.S. equities plunged to a minimal $220 million (preliminary data), after averaging $2.9 billion in the first seven months of the year. In addition, in September, inflationary concerns played havoc with the U.S. stock and bond markets. The increase in the Federal Reserve's discount rate to 6% and subsequent increase in commercial banks' prime rate gave only short-lived relief to the markets but succeeded in putting the dollar on a steadier course. With foreign investors apparently giving more consideration to the dollar, foreign investment in U.S. equities shot up to $3.0 billion in September despite a sharply down and volatile market.

The third quarter now seems like the distant past in light of an historic October. Surprisingly, preliminary data indicate foreign investors were not fleeing U.S. equities in October. Treasury preliminary data places net purchases at $2.4 billion. However, the sharp fall of U.S. interest rates in the wake of the market crash spelled the end of any dollar stability for the rest of the year. Given a depressed market and seemingly abandoned dollar, SIA confidential and preliminary data indicate foreign investors were large net sellers of equities in November, with rough estimates ranging from $4.0 to $5.5 billion. December's data will prove the deciding factor. The weak position of both the dollar and stock market does not augur well for a positive sentiment on the part of foreign investors. Hence, unless preliminary data are widely off the mark, the fourth


Foreign Net Purchases of U.S. Equities
($ in Billions)
25
20
15
10
5
0
$4.9
$18.7
$23.5
1985
1986
I-IIIQ '87
Europe
Canada
L.A. & Caribbean
Other
Asia

quarter of 1987 could be the first one that foreign investors were net sellers of U.S. equities since the first quarter of 1985.

After an interest-rate propelled recovery in September, the dollar spent the remainder of the year plummeting to a series of historic lows. All told, from year-end 1986 to year-end 1987, the yen and German mark gained 30.6% and 22.5%, respectively, against the dollar. The British pound, Swiss franc and French franc also moved up sharply--20% to 28%--on the dollar, while the Canadian dollar appreciated 6.3% over the year.

Foreign Activity in U.S. Equities

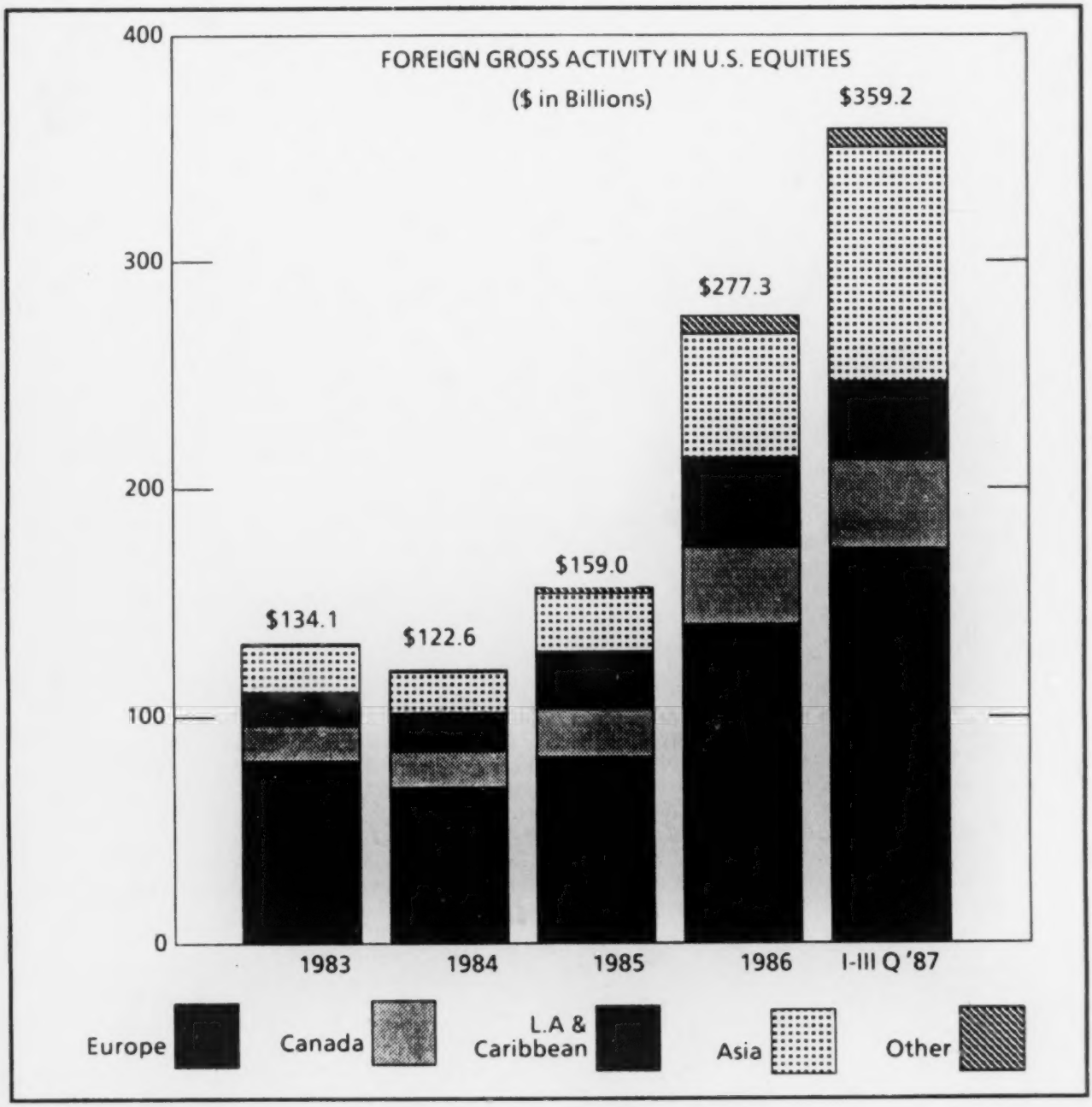
Gross Activity

Foreign gross transactions in U.S. equities have been racing toward a new high in 1987. In the third quarter, foreign activity escalated to $136.8 billion, 25% over the second-quarter level and 21% over the first quarter's record of $113.0 billion. With preliminary data placing October's frenzied activity at about $58.0 billion, foreign gross activity in U.S. equities had already climbed to an estimated $417.0 billion in the first ten months of 1987. Allowing for the subsiding of transactions from October's hectic pace, foreign gross activity in U.S. equities in 1987 could well fall not too far under the $500.0 billion mark. Whatever the final number, 1987's activity will represent a dramatic escalation from 1986's record $277.5 billion.

While every major region increased gross activity in the third quarter, it was the 70% leap in Japanese transactions that pushed gross transactions to the quarterly high. Based on Japanese activity, transactions from the Asian region jumped 53% to $44.6 billion from $29.3 billion. With activity by every major country upscaled, European transactions rose 18% to $63.5 billion from $53.9 billion in the the second quarter. Canadian and Latin American and Caribbean investors stepped up transactions in U.S. stocks by 13% and 9% to $14.1 billion and $11.9 billion, respectively.

Net Purchases

Foreign investors reduced net purchases of U.S. equities by 42% to $5.0 billion in the third quarter from a near-record $8.6 billion in the second. Here too, Asian investor were the influencing factor, with net purchases slashed by 62% to $1.7 billion. To a lesser extent, European enthusiasm for U.S. equities was also dampened, with net purchases decreased by 34% to $2.1 billion. In contrast, Canadian investors increased net acquisitions to $189 million, three times the second-quarter level, and Latin American and Caribbean investors boosted net purchases by 11% to $732 million.


FOREIGN GROSS ACTIVITY IN U.S. EQUITIES
($ in Billions)
400
300
200
100
0
$134.1
$122.6
$159.0
$277.3
$359.2
1983
1984
1985
1986
I-III Q '87
Europe
Canada
L.A & Caribbean
Asia
Other

European Net Purchases

European investors cut back net purchases of U.S. equities by 34% in the third quarter to $2.1 billion from $3.2 billion in the second. Both U.K. investors and those located in the Belgium-Luxembourg countries maintained the same investment levels from quarter to quarter. While Dutch investors reduced net purchases by 23%, net purchases by Swiss investors plummeted to $30 million from $451 million in the second quarter. In a dramatic reversal, French investors made net sales of $17 million in the third quarter in contrast to net purchases of $562 million in the second. German net selling of U.S. equities moderated to $80 million in the third quarter from $138 million.

Encouraged by strong economic growth, the U.K. market had enjoyed a runup to a mid-July peak. The unexpected increase in the Bank of England's money market dealing rates in August sent London shares on a record plunge. Fears of robust consumer demand prompting increased imports and worsening Britain's trade balance, which unexpectedly swung to the negative in May, reportedly prompted the rate boost.[1] Despite the end of the U.K. market's strong advance in the third quarter, these investors weren't ready to increase investments in U.S. equities. Net purchases of $1.5 billion were made, virtually the same level of investment as in the second quarter.

All told, U.K. investors have acquired $5.5 billion of U.S. equities in the first three quarters, measuring about 55% of total European net purchases. While U.K. investors remain the kingpin of European investors in U.S. equities, they have been outdistanced by Japanese investors. These investors have purchased $9.5 billion or 40% of the total foreign investment in equities in the first three quarters.

German investors continued to shun U.S. equity investment in the third quarter. Net sales of $80 million were made, compared with $138 million in the second quarter. West Germany enjoyed a record trade surplus in 1987, about $70.0 billion, but faced lackluster growth given the appreciation of the mark and slack in domestic demand. Preliminary estimates place real GNP at 1.7% in 1987, a sharp decline from 2.5% in 1986. German policymakers have focused on strong growth in the money supply as a signal of future inflationary pressures and nudged interest rates up over the third quarter. However, although in the doldrums over the first half of the year, the German stock market got a boost over the third quarter on the reported bargain shopping of foreign investors.

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[1] "London Shares Post Record Drops," The Wall Street Journal, 8/7/87.

TABLE I

FOREIGN ACTIVITY IN U.S. EQUITIES
($ Millions)

	Second Quarter 1987		Third Quarter 1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$53,854	$3,174	$63,540	$2,103
Belgium-Luxembourg	3,048	130	3,209	123
France	4,133	562	5,366	(17)
Germany	3,786	(138)	4,742	(80)
Netherlands	2,995	476	3,325	367
Switzerland	13,551	451	16,814	30
United Kingdom	24,133	1,527	27,295	1,524
Canada	12,482	62	14,103	189
Latin America & Caribbean	10,956	660	11,932	732
Bermuda	2,520	(36)	2,628	229
Netherlands Antilles	3,344	(2)	3,452	41
Asia	29,254	4,390	44,649	1,669
Hong Kong	3,063	173	3,093	359
Japan	20,348	4,098	34,613	1,923
"Other Asia"*	4,152	(95)	4,743	(1,034)
Total All Countries	**$109,388**	**$8,592**	**$136,760**	**$5,016**

Source: U.S. Treasury
* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

French investors' attraction to U.S. equities in the first half of 1987 was exceptional, with net purchases totalling $1.8 billion. These investors, however, cooled dramatically to U.S. equities in the third quarter, making net sales of $17 million. While the French stock market continued to rally in the first quarter, the market was dragged down over the remainder of the year by concerns over weakness in the export sector and the growing trade deficit. Although French investors did not have a strong domestic stock market to turn to in the third quarter, interest rates did trend moderately upward. In contrast, after languishing in the first half of the year, the Swiss market picked up somewhat in the third quarter. Swiss investors slashed net purchases of U.S. equities to $30 million from $451 million in the second quarter

Canadian Investors

The Canadian economy has benefitted from the stronger-than-expected growth of its trading partner, the U.S., and from the recovery of energy and other key resource prices, with growth estimated at 3.7% for 1987.[2/] At the same time, Canadian interest rates have been maintained at comparably high levels to stem inflationary pressures and protect the Canadian dollar. While the Canadian stock market sagged in the second quarter after a stellar first-quarter performance, it advanced moderately in the third. A return to considerations of equity investments also prompted Canadian investors to increase their acquisition of U.S. equities. Canadian net purchases were increased to $189 million in the third quarter from a low $62 million in the second.

Asian Investors

Net investment in U.S. equities by Asian investors slid a steep 62% to $1.7 billion in the third quarter from $4.4 billion in the second. The falloff is a reflection of a dramatic reduction in Japanese net purchases and a significant increase in net sales by the oil-exporting countries. The oil-exporting countries have long been drawing down reserves in U.S.-dollar denominated assets. However, net sales of $1.0 billion of equities in the third quarter is a significant escalation from recent levels.

While Japanese investors preferred U.S. equities to fixed income investment in 1987, concerns over the path of the dollar prompted a return to home markets and a subsequent slowdown in Japanese long-term investment outflows in the third quarter.[3/] According to Ministry of Finance figures, these flows subsided from $6.7 billion in August to $3.3 billion in September, after averaging $10 billion in the first seven months of the year. Reflected in terms of U.S. equities, net purchases plunged 53% to $1.9 billion in the third quarter from $4.1 billion in the second. Nevertheless, in the first three quarters of 1987, Japanese investors added $9.5 billion of U.S. equities to their portfolios, 40% of total foreign investment and just 5% less than European net purchases.

2/ "International Economic Outlook," Irving Trust Company, 12/87

3/ "International Fund Management", Financial Times Survey, 11/16/87.

TABLE II

FOREIGN NET PURCHASES OF U.S. EQUITIES

First Three Quarters of 1987
($ Millions)

	First Quarter	Second Quarter	Third Quarter	Total
Europe	$4,682	$3,174	$2,103	$10,004
Belgium-Luxembourg	180	130	123	456
France	1,242	562	(17)	1,787
Germany	97	(138)	(80)	(121)
Netherlands	213	476	367	1,068
Switzerland	379	451	30	860
United Kingdom	2,419	1,527	1,524	5,503
Canada	327	62	189	577
Latin America & Caribbean	1,011	660	732	2,432
Bermuda	(15)	(36)	229	178
Netherlands Antilles	491	(2)	41	558
Asia	3,616	4,390	1,669	9,671
Hong Kong	98	173	359	624
Japan	3,495	4,098	1,923	9,516
"Other Asia"	(270)	(95)	(1,034)	(1,398)
Total All Countries	**$9,833**	**$8,592**	**$5,016**	**$23,508**

Source: U.S. Treasury
Note: Quarterly data unrevised; Total reflects revised data.

Foreign Activity in U.S. Corporate Bonds

From the second to third quarter, foreign investors' interest in acquiring U.S. corporate bonds was almost unchanged. Net purchases increased 5% to $6.8 billion from $6.4 billion in the second quarter. As of September, foreign investors had made net purchases of $20.9 billion of corporate bonds, a bit under half of 1986's $43.7 billion. Conditions in the U.S. corporate bond markets deteriorated as the third quarter progressed, as the sliding dollar and trade deficit exacerbated inflationary fears. Yields on corporate bonds rose in both July and August, then jumped 60 basis points to 10.75% in September in the aftermath of the increase in the Federal Reserve's discount rate.4/ Foreign investors were most active bond market participants in September, given an increase in yields and respite for the dollar.

TABLE III

FOREIGN ACTIVITY IN
U.S. CORPORATE BONDS
($ Millions)

	Second Quarter 1987		Third Quarter 1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$24,363	$6,179	$18,385	$6,696
Belgium-Luxembourg	516	(39)	994	76
France	597	33	590	54
Germany	1,177	(83)	1,137	(16)
Switzerland	1,572	352	1,660	723
United Kingdom	19,569	5,721	12,311	5,668
Asia	4,594	(480)	3,572	(384)
Japan	3,171	(423)	2,559	(271)
"Other Asia"	824	3	498	(242)
Total All Countries	**$31,571**	**$6,429**	**$24,181**	**$6,755**

Source: U.S. Treasury

4/ Yield comparisons in this report based on statistical data presented in World Financial Markets, Morgan Guaranty Trust Company.

European net purchases of corporate bonds rose 8% to $6.7 billion from $6.2 billion. U.K. investors' interest in corporate bonds remained unchanged from quarter to quarter, net purchases of $5.7 billion, similar to these investors' activity in U.S. equities. The U.K. authorities also showed their concern for containing inflationary pressures in the third quarter by boosting a key interest rate. The upswing on yields on U.K. corporate bonds from 10.15% to 10.43% was an almost equal basis point match with the increase in U.S. yields. Hence, U.K. investors had little reason to vary their investment strategy. These investors have been the chief foreign buyers of U.S. corporate bonds, greatly surpassing activity by other foreign investors. Although the overall level of foreign investment in U.S. corporate bonds in 1987 is down from the prior year, U.K. investors' net purchases of $16.8 billion in the first three quarters measure some 80% of total foreign net buying.

On the other hand, activity in corporate bonds by Japanese investors is a far cry from 1987. These investors made net purchases of $366 million in the first three quarters of 1987, in stark comparison to $5.1 billion in 1986. After making net purchases of $1.1 billion in the first quarter of the year, yield/dollar considerations sent these investors to other markets. Given the yen's continued strong advance on the dollar in the third quarter, these investors maintained a net divestiture posture toward U.S. corporate bonds. Net sales of $271 million were made in the third quarter, compared with $423 million in the second quarter.

Foreign Activity in U.S. Treasuries

Foreign activity in U.S. Treasuries in the past year and a half has been dominated by the coordinated actions of central banks to quell pressures on the dollar in the foreign exchange markets. With the exception of a turbulent August, the third quarter held more favorable than unfavorable news for the dollar, while growth prospects for the European countries took somewhat of a negative shift. Upward pressure on the dollar was such that the Federal Reserve actually intervened in early August to counter the dollar's rise against mark. In addition, early in the quarter rising tensions in the Persion Gulf and rumors of large dollar purchases from the Middle East tended to strengthen the dollar's role as a store of value and currency of choice for flight capital at times of political uncertainty. 5/ Subsequently, central banks did not intervene in exchange markets to the extent of the two prior quarters. Net purchases of Treasuries by foreign official institutions decreased 38% to $6.6 billion in the third quarter from $10.7 billion in the second. For the first three quarters of the year, foreign official institutions acquired $25.4 billion of Treasuries, evidence of trying times in the foreign exchange markets.

5/ Quarterly Review, Federal Reserve Bank of New York, Autumn 1987.

Private foreign institutions and organizations were large-scale net sellers of Treasuries in the first half of the year. Net purchases of $897 million in the third quarter were not quite enough to offset earlier net sales, making these investors net sellers of $397 million through the first nine months of the year. International organizations made substantial net sales of $4.7 billion in the third quarter. In sum, foreign activity in Treasuries in the third quarter resulted in net purchases of $2.8 billion, a drop of 67% from net purchases of $8.6 billion in the second quarter.

Much has been made of the Japanese yen's advance on the dollar over the year. During the third quarter, the yen was the recipient of additional upward pressures as there were indications that the Japanese export sector was adjusting to appreciation of the yen, hence improving overall economic prospects for the Japanese economy. In August, the yen spurted a sharp 5% on the dollar. Net purchases of Treasuries stemming from Japan were boosted by 89% to $2.0 billion from $1.1 billion in the second quarter. Also contributing to the $5.4 billion of Treasuries acquired by the Asian region were net purchases of $5.3 billion stemming from Taiwan (not shown in Table IV).

TABLE IV

FOREIGN ACTIVITY IN U.S. TREASURY NOTES AND BONDS
($ Millions)

	1st Quarter 1987 Net Purchases	2nd Quarter 1987 Net Purchases	3rd Quarter 1987 Net Purchases
Europe	$8,959	$5,444	$2,594
Switzerland	1,979	1,701	(275)
West Germany	3,840	3,797	2,441
United Kingdom	1,540	(1,031)	(315)
Asia	(2,068)	2,825	5,444
Japan	(766)	1,081	2,040
"Other Asia"	(1,456)	(341)	(39)
Nonmonetary Int'l & Regional Organizations	172	(2,179)	(4,660)
Total All Countries	**$6,742**	**$8,575**	**$2,796**

Source: U.S. Treasury
Note: Treasury has made extensive revisions in 1986 and first-quarter 1987 data. We have incorporated these revisions in the Table.

Following closely after the Japanese yen, the German mark is the second major currency against which the dollar has had its troubles. With more reluctance than the Japanese, German policymakers have resisted adjusting interest rates to curb global imbalances given their concern over rapid money supply growth and inflationary pressures. However, large-scale net purchases of Treasuries have stemmed from Germany, with third-quarter net purchases of Treasuries totaling $2.4 billion compared with $3.8 billion in the second. Transactions originating from Switzerland and the U.K. resulted in net sales of $275 million and $315 million of Treasuries, respectively, in the third quarter.

U.S. Investor Activity in Foreign Stocks

Investors worldwide took a more moderate approach to equity investment in the third quarter. Just as foreign investment in U.S. equities slowed, so too did U.S. interest in acquiring foreign stocks. While U.S. investor interest in acquiring foreign stocks was strongest in August coinciding with heated interest in the U.S. market, the general uptrend in interest rates coupled with reduced growth

TABLE V

U.S. INVESTORS' ACTIVITY
IN FOREIGN STOCKS
($ Millions)

	Second Quarter 1987		Third Quarter 1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$25,691	$1,941	$29,187	$925
France	1,408	4	1,651	(27)
Germany	2,773	203	2,065	115
Netherlands	1,493	281	1,440	(74)
Switzerland	1,503	157	1,681	257
United Kingdom	16,626	888	20,303	353
Canada	4,530	696	4,746	566
Asia	15,016	(2,190)	14,043	(1,663)
Japan	12,848	(2,004)	11,956	(1,398)
Other	3,276	258	3,778	106
Total All Countries	**$48,513**	**$705**	**$51,754**	**$(66)**

Source: U.S. Treasury

prospects for certain countries may have dampened enthusiasm for equity investment. Net sales of foreign stocks in September negated the net buying activity of the prior two months.6/ Overall, a moderated approach to European and Canadian stocks plus continued large sales of Japanese stocks resulted in net sales of $66 million of foreign stocks by U.S. investors in the third quarter. For the first nine months of 1987, U.S. investors acquired $2.3 billion of foreign stocks compared with $1.9 billion for 1986.

Gross transactions continued to scale to new highs in the third quarter. U.S. investor activity in foreign markets rose 7% to $51.8 billion from $48.5 billion in the second quarter. Gross transactions at the end of September, $68.9 billion, have surpassed by 42% full-year 1986 gross activity of $48.7 billion. If activity continued at the same pace in the fourth quarter, U.S. transactions in foreign stocks in 1987 would reach an estimated $92.0 billion.

Despite brighter prospects for the Japanese economy, U.S. investors remained wary of Japanese stocks in the third quarter. Japanese policies to encourage domestic demand reportedly began offsetting the rising yen's toll on the export sector. From 0% growth in the second quarter, forecasters revised Japanese economic growth to 3%-3.5% in 1987. In addition, while foreigners long-standing net divestitures of Japanese stocks have been predicated on overvaluation and not-for-the-faint-hearted volatility, the Tokyo market survived October better than most major markets. Nevertheless, with October's events off in the future and U.S. investors not yet ready to bet on improved economic fundamentals, U.S. net sales of Japanese stocks came to $1.4 billion in the third quarter compared with $2.0 billion in the second.

In a broad-based waning of interest, U.S. investors reduced net purchases of European stocks by 52% to $925 million from a high $1.9 billion in the second quarter. After making net purchases of $2.2 billion in the first half of the year, U.S. investors cut back net acquisition of British stocks to $353 million. The London market was stalled in the third quarter by consideration of an oversupply of new issues, a rise in the banks' base lending rates and fears of an overheating economy.7/ While the U.K. market managed a gain of around 5% over the

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6/ SIA's Investor Activity Report shows all institutional investors, in aggregate, were also net sellers of NYSE stocks in September. With the exception of a wash in May and net sales in April, institutional investors had been net buyers in every other month.

7/ "How rights issues go wrong," Economist, 9/5/87.

quarter, this represents a distinct letdown from the 38% chalked up in the first half of the year. In addition, U.S. investors moderated net buying of German stocks by 43% to $115 million from $203 million. Although the German stock market has been mired in the doldrums, many German stocks have been considered undervalued.

U.S. investors swung to net sellers of stocks of companies located in France and the Netherlands. The French stock market has been bogged down over much of the year by weak economic growth prospects. The fate of France's export sector is closely linked to the German economy which has had slow growth in 1987. U.S. investors showed little interest in French stocks in the second quarter, net purchases of $4 million, and swung to net sellers of $27 million in the third quarter. In contrast, U.S. investors continued to show considerable interest in Dutch stocks, with net purchases totaling $1.1 billion through the first three quarters of 1987.

Swiss stocks were the exception to U.S. investors general drawback from European investment. The Swiss market, which had lackluster performance in the first half of the year, showed improvement in the third quarter. U.S. investors' second-quarter bargain hunting, net purchases of $157 million, was increased by 64% in the third quarter to $257million. However, the Swiss market suffered one of the severest October setbacks, reportedly on the withdrawal of foreign investment.

Coinciding with the Canadian stock market's performance, U.S. investors' net purchases of Canadian stocks were highest in the first quarter of the year, $904 million, and have since declined. Net purchases of $566 million were made in the third quarter. Relatively strong performances by both the Canadian market and economy, coupled with the market's heavy weighting of commodity-related issues for investors concerned with inflationary pressures, brought the level of U.S. investment in Canadian stocks to an exceptional $2.2 billion in the first three quarters of 1987.

Carolyn Hildebrandt
Assistant Vice President

SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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Securities Industry Association
120 Broadway
New York, New York 10271

Phone (212) 608 · 1500

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UPDATE ON FOREIGN ACTIVITY IN U.S. EQUITIES

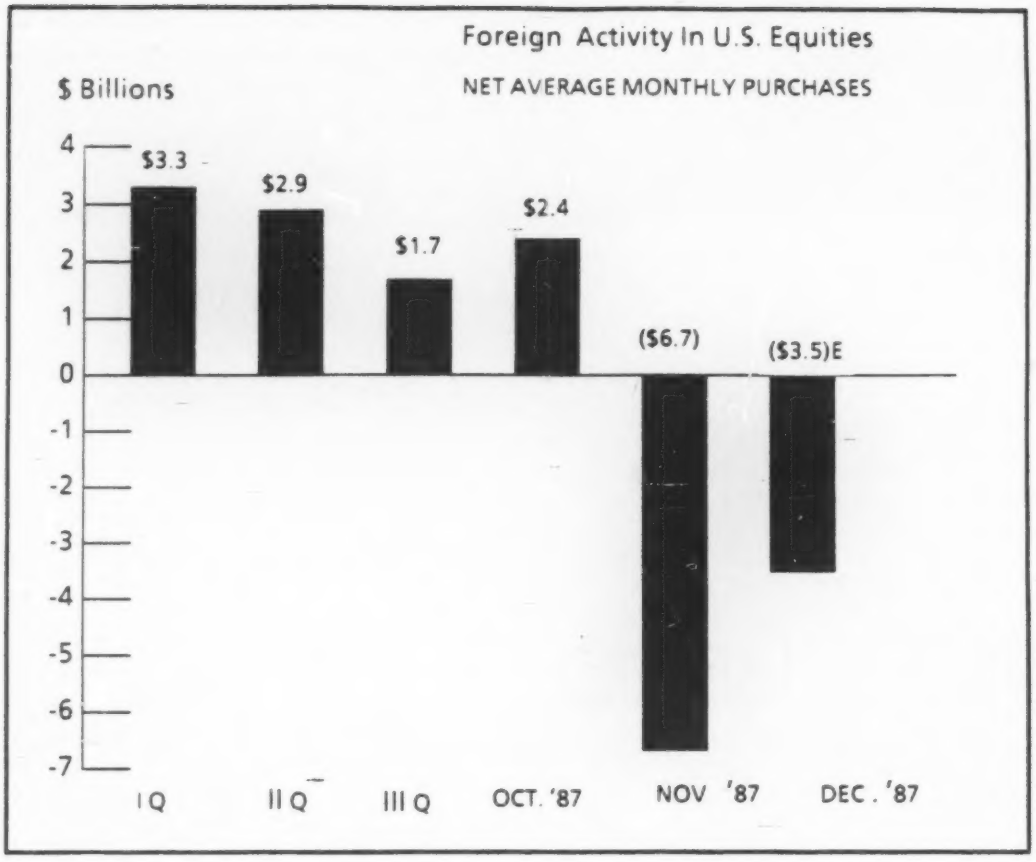
"Turnaround after the Crash"

1987 Estimates

Given the dramatic first-quarter start, foreign investment in U.S. equities was headed for a new record in 1987. Second-quarter net investment, although a shade below the first-quarter pace, brought net purchases within a hairsbreadth of 1986's $18.7 billion. With the stock market on the path to glory albeit an increasingly volatile one in the first two months of the third quarter and the dollar's period of stability brought to an abrupt end, foreign investors moderated their enthusiasm for U.S. equities. Nevertheless, by the end of September, foreign net purchases of $23.5 billion of U.S. equities eclipsed 1986's record by 26%.

Despite a tumultuous October for the U.S. stock market as well as markets around the world, foreign investors were still net buyers of U.S. equities. Treasury data show comparably sizable net purchases of $2.4 billion. On balance, the rising stock market had pulled foreign funds to U.S. equities through much of the year. The dollar's troubles, for the most part, were offset by consideration of rising and "cheap" U.S. stocks. However, an uncertain environment followed in the wake of October's crash, with the last two months of the year marked by both a languishing stock market and plunging dollar.

Preliminary Treasury data show foreign investors made large-scale net divestitures of U.S. equities in November, $6.7 billion. According to SIA preliminary and confidential data, the net divestiture trend continued in December, with foreign net sales estimated at $3.0-$4.0 billion. Activity in these two months negated earlier estimates of record foreign investment in 1987. Hence, foreign net purchases of U.S. equities in 1987 will not set a new record but rather take second place to the 1986 record. We estimate net purchases will fall in a still very respectable range of $15.0-$17.0 billion.



While net purchases are not likely to set a new record, the catchphrase "globalization" is underscored by the level of foreign transactions in U.S. equities. At about $451.2 billion through November, gross transactions scaled to an estimated $485.0 billion in 1987, about 75% more than the 1986 record $277.5 billion.

Whatever the final numbers, foreign investors have provided significant support for U.S. markets in recent years. We estimate foreign activity accounted for 12%-14% of the public volume on the NYSE, a step above our 1986 estimate. However, as seen in the dramatic turnaround at year-end, foreign capital is not a never-ending stream of support for U.S. equity prices. While U.S. markets provide the depth and breadth to attract foreign investors, market trends and the dollar's path remain fundamentals to foreign investment decisions whether or not to buy U.S. corporate equities.

Carolyn Hildebrandt
Assistant Vice President

SIA

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UPDATE ON
FOREIGN ACTIVITY IN U.S. EQUITIES
"1987"

Still a tall shadow...

Foreign enthusiasm for U.S. equities in 1987 ended with the October crash. Although diminishing on a quarterly basis as the year progressed, foreign net purchases of U.S. equities reached an unprecedented $25.9 billion by the end of October. Indeed, foreign activity in October resulted in net acquisitions of $2.4 billion, with the probability that whatever net selling occurred in the latter half of the month was not enough to offset net purchases in the first half or any post-crash bargain hunting. Nevertheless, a floundering stock market and falling dollar sent foreign investors out of the U.S. market for the remainder of 1987. Net sales in November and December totaled $9.7 billion.

Hence, given large-scale net divestitures after the market crash, foreign net purchases of U.S. equities in 1987 take second place to the 1986 record. While falling 13% short of the 1986 record of $18.7 billion, foreign net purchases of $16.3 billion in 1987 still cast a tall shadow over the previous record, $5.8 billion set in 1981.

Cut dramatically by net divestitures of $8.1 billion in the fourth quarter, European net purchases of U.S. equities plunged in 1987 to $1.9 billion from $9.6 billion in 1986. In the fourth quarter, particularly hefty divestitures of $2.0 billion and $5.0 billion stemmed from Switzerland and the U.K., respectively. Unlike most major foreign investors, Japanese investors remained net purchasers of U.S. equities in the fourth quarter, $1.8 billion. Hence, while Japanese investors supplanted U.K. investors as the largest foreign acquirer of U.S. equities at the beginning of the year, they surpassed all European investors by the end. Accounting for 70% of total foreign net purchases, Japanese investors made net purchases of $11.4 billion of U.S. equities, compared with $3.3 billion in 1986.

Foreign Activity in U.S. Equities
($ Millions)

	1986		1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$141,811	$ 9,559	$232,283	$ 1,864
Belgium-Luxembourg	8,525	663	11,708	435
France	9,581	459	19,920	903
Germany	9,992	341	16,204	(74)
Netherlands	6,246	936	11,267	890
Switzerland	36,982	1,560	59,493	(1,162)
U.K.	64,608	4,826	103,820	517
Canada	34,584	816	49,524	1,116
Latin America & Caribbean	39,192	3,031	46,870	1,318
Bermuda	11,836	794	10,428	(101)
Netherland Antilles	11,606	226	15,551	224
Asia	55,285	4,851	142,349	11,535
Hong Kong	8,547	403	12,500	658
Japan	26,904	3,305	102,554	11,365
"Other Asia"	16,269	976	20,545	(1,361)
Total All Countries	$ 277,509	$18,719	$481,500	$16,273

Source: U.S. Treasury

Foreign gross transactions in the U.S. equity market escalated at a fast and furious clip in 1987. Foreign transactions rose to $481.5 billion, leaping 74% past the 1986 record of $277.5 billion.

A Quick Retreat...

U.S. investors turned from foreign shores in the third quarter; net sales totaled $66 million. With the worldwide setback in equity markets in October, U.S. investors stepped up net sales of foreign equities to a significant $2.1 billion in that month. Although U.S. net selling of foreign stocks receded from the heightened October level in the following two months, fourth-quarter net activity in foreign stock markets resulted in large net sales of $3.7 billion. Hence, for the first time since 1978, U.S. investors were net sellers of foreign stocks for the year. Net sales of $1.4 billion in 1987 contrast with net purchases of $2.4 billion in 1986.

Carolyn Hildebrandt
Assistant Vice President & Director
of Macroeconomic Studies

SIA

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Volume XI, No. 4 April 13, 1988

Foreign Activity in U.S. Securities

"Highlights"

1. Given net sales of $7.2 billion in the fourth quarter, foreign net purchases of $16.3 billion of U.S. equities in 1987 fell 13% short of 1986's record $18.7 billion but rank far above any previous annual level.

2. Japanese investors were the major players worldwide in equity markets in 1987, overtaking British investors for the number one spot. Japanese net purchases accounted for 70%, or $11.4 billion, of total foreign investment in U.S. stocks in 1987.

3. For the second consecutive year, foreign gross transactions leaped by over 70%, to a record $481.5 billion in 1987 from $277.5 billion in 1986.

4. Foreign investors remained wary of U.S. equities in January and February of this year. We estimate that gross activity averaged $28 billion and buying interest was minimal. By contrast, gross activity and net purchases averaged $40 billion and $1.4 billion, respectively, in 1987.

5. A pullback after the crash coupled with a general lack of interest by Japanese investors in 1987 resulted in foreign net purchases of $22.7 billion of U.S. corporate bonds, a 48% plunge from 1986's $43.7 billion.

6. Foreign investors did not exit all U.S. securities markets after the crash. While a significant $9.7 billion left the equity market in November and December, $8.3 billion was invested in Treasuries by foreign organizations and individuals who had shown little interest in these securities earlier in 1987. As in most periods of economic uncertainty, this trend is consistent with a "flight to quality".

7. What started out as a strong year for U.S. investment in foreign stocks ended in net sales of $1.4 billion, as U.S. investors made fourth-quarter sales of $3.7 billion. Indeed, worldwide investors headed for home after October.

Overview

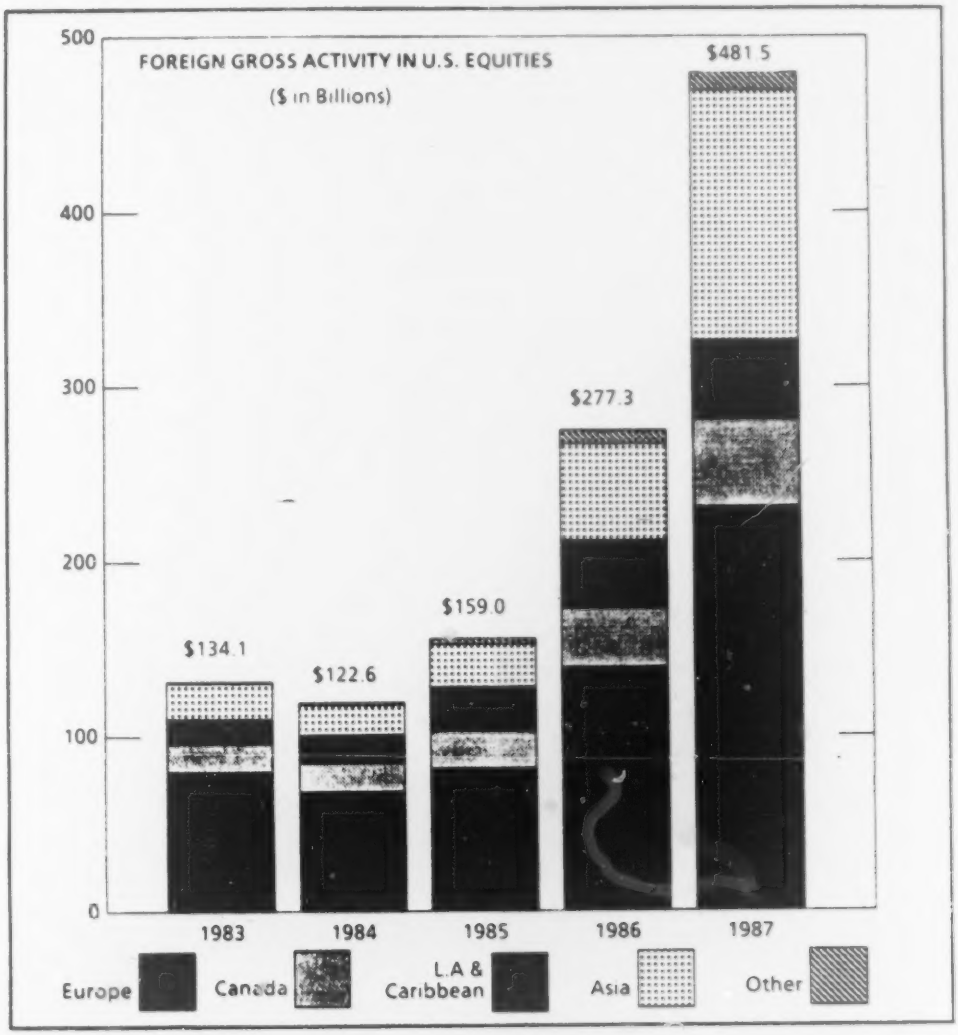
Foreign investors have sent unprecedented amounts of capital to the U.S. securities markets in recent years. Not only did foreigners continue to invest in U.S. equities at a record-setting pace in early 1987, but by midyear their buying had accelerated to such that 1986's record, $18.7 billion, was almost eclipsed. By the end of September, the 1986 record was surpassed by 14%. October's events sent shudders through financial markets worldwide. On balance, foreign investors were still net purchasers of U.S. equities in October, $2.4 billion. However, with unending optimism for the U.S. stock market dashed and a free-falling dollar, foreign investors were large net sellers of equities, $9.7 billion, in the last two months of the year. Although foreign net purchases of U.S. equities in 1987 failed to top the 1986 record, $16.3 billion ranks far above previous levels of foreign investment and stands as testimony to the critical role of foreign investors in the U.S. equity market.

Foreign investors had focused on the rising U.S. stock market in much of 1987, with net investment ebbing and flowing in unison with the market's climb. For the most part, the dollar remained a secondary consideration in the decision to invest in U.S. equities. Indeed, as long as the stock market surged uphill, the depreciating dollar "cheapened" stock prices for foreign investors. October's events undermined investors' confidence in both the stock market and the dollar and highlighted a host of economic imbalances, both domestic and global.

While policymakers attempted to address the Federal deficit, the perception that interest rate increases would jeopardize the economy caused the dollar's tailspin. The stock market watched policymakers hammer out a disappointing deficit-reduction package and finished the year with anemic annual gains. The dollar went reeling to record lows at year-end because of doubts as to the G-7's commitment on exchange rate stabilization. In the fourth quarter alone, the dollar lost between 15%-21% against the major foreign currencies.

The new year began with a show of strength by the G-7 countries that exchange rate stability was a top priority. Announcements of interest rate reductions in three European countries coupled with aggressive intervention by central banks in the foreign exchange markets started the dollar's recovery. Also reassuring were economic signs that the market "adjustment" had not brought the U.S. economy to the brink of a recession. Nevertheless, with considerably lower volume, the stock market advanced only modestly from 1987's close in January and February.

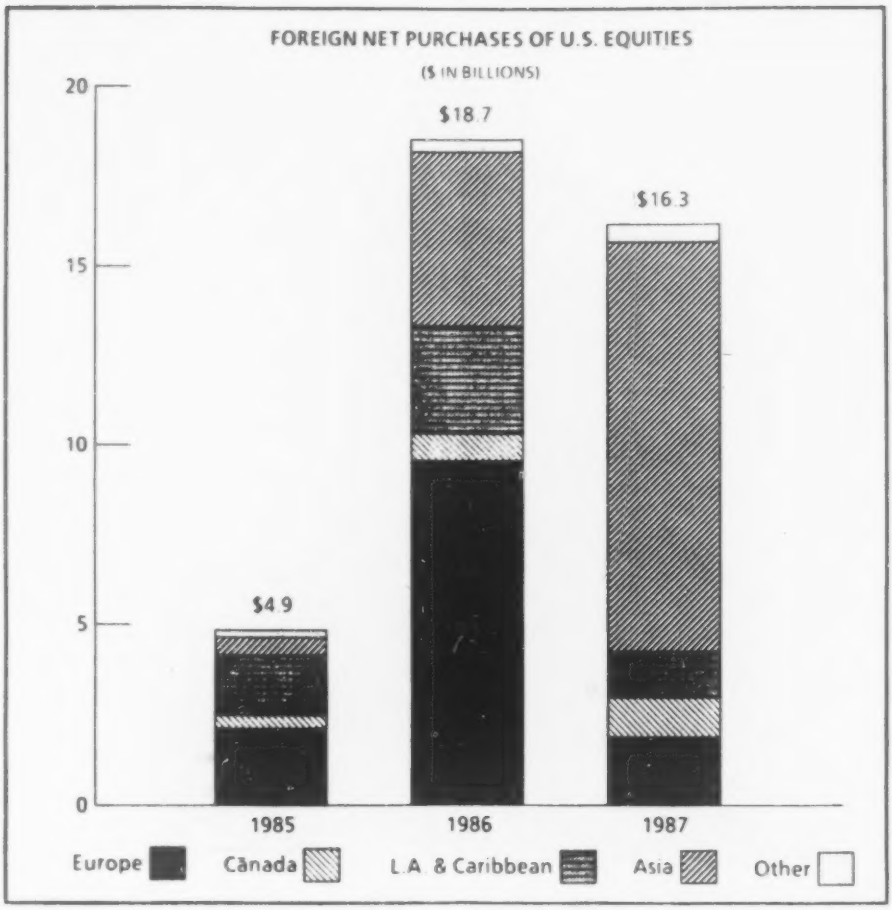
Foreign investors went to the sidelines as far as investment in U.S. equities was concerned in January and February. Treasury's preliminary data show gross activity of about $25.8 billion and net purchases of $25.0 million. Moreover, based on SIA's preliminary February data, gross activity is estimated at about $30.0 billion with minimal net activity. Needless to say, foreign investment in U.S. equities is off to a weak start in 1988. By contrast, gross activity and net purchases averaged monthly about $40.0 billion and $1.4 billion, respectively, in 1987.



Foreign Activity in U.S. Equities

Gross Activity

Keeping step with 1986's momentum, foreign gross transactions in U.S. equities leaped to $481.5 billion in 1987 from $277.5 billion in 1986. Hence, 1987 is the second consecutive year in which the pace of foreign activity spurted by over 70%. As in 1986, the impetus behind the fast and furious clip came from Asia. In 1987, Asian investors upped gross activity by a dramatic 157% to $142.3 billion from $55.3 billion in 1986. European investors increased gross transactions by 64% to $232.3 billion from $141.8 billion in 1986. Canadian and Latin American and Caribbean investors boosted activity by 43% and 20%, respectively.



Net Purchases

If not for the aftermath of the October crash, 1987 would have been another record year of unprecedented foreign net purchases of U.S. equities. Large net sales in November and December brought net divestitures to $7.2 billion in the fourth quarter. Despite this dramatic reversal, foreign net purchases of U.S. equities in 1987 came in at $16.3 billion. While this fell short of the 1986 record of $18.7 billion by 13%, it is almost 3 times the previous record of $5.8 billion set in 1981.

European net purchases plunged 81% to $1.9 billion in 1987 from $9.6 billion in 1986. Net sales of a hefty $8.1 billion were made in the fourth quarter. So too, Latin American and Caribbean net purchases were reduced by net sales of $1.1 billion in the last quarter of the year. For the year, these investors made net purchases of $1.3 billion, a 57% decrease from 1986's $3.0 billion. In contrast, activity by Canadian and Asian investors, neither of which were net sellers in the fourth quarter, resulted in higher net purchases in 1987. Canadian investors stepped up net purchases by 37% to $1.1 billion from $816 million in 1986. Fueled by a vociferous Japanese appetite for U.S. equities, Asian net purchases soared to $11.5 billion in 1987 from $4.9 billion in 1986.

European Investors

The fourth quarter brought a halt to the climb of net purchases of U.S. equities by European investors. At the end of the third quarter, European net purchases had reached $10.0 billion. Net sales of $8.1 billion after the market decline reduced net purchases to $1.9 billion in 1987. However, with the exception of Germany and Switzerland, investors in other European countries remained net purchasers in 1987 albeit at lower levels generally than in 1986.

By the end of the third quarter, U.K. net purchases of U.S. equities had reached a record $5.5 billion. The market crash brought a swift reversal, net sales of $5.0 billion, reducing net acquisitions to $517 million in 1987. Net purchases in 1987 pale in comparison to net purchases of $4.8 billion in 1986. The U.K. market peaked in mid-year, about the same time Britain's current account swung into deficit. Worry over an overheating of the U.K. economy and inflationary pressures became more pronounced as the second half of the year progressed, dampening any market improvement. Despite an overall lackluster performance for their domestic market, U.K. investors reportedly headed for home in the fourth quarter and plan to stay there. A survey of British pension fund managers shows that, at year-end 1987, total assets invested in U.K. equities increased to 58% from 53% in 1986, while foreign equities dropped to 16% from 22%.[1/]

Swiss investors were also major net sellers of U.S. equities in the fourth quarter, $2.0 billion. These investors were net sellers of $1.2 billion of U.S. equities in 1987, in contrast to net purchasers of $1.6 billion in 1986. Growth of the Swiss economy turned sluggish in 1987. The strong Swiss franc, which gained over 25% against the dollar, as well as the slowing growth of Switzerland's major trading partners undermined the export sector. With their domestic stock market declining during the first half of 1987, Swiss investors turned to the U.S. market. A third-quarter uptick in the Swiss market was negated by the October collapse and the Swiss market suffered one of the severest setbacks for the year.

1/ "British taking few chances," Pension & Investment Age, 3/21/88.

TABLE I

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1986		1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$141,811	$ 9,559	$232,283	$ 1,864
Belgium-Luxembourg	8,525	663	11,708	435
France	9,581	459	19,920	903
Germany	9,992	341	16,204	(74)
Netherlands	6,246	936	11,267	890
Switzerland	36,982	1,560	59,493	(1,162)
U.K.	64,608	4,826	103,820	517
Canada	34,584	816	49,524	1,116
Latin America & Caribbean	39,192	3,031	46,870	1,318
Bermuda	11,836	794	10,428	(101)
Netherlands Antilles	11,606	682	15,551	(163)
Asia	55,285	4,851	142,349	11,535
Hong Kong	8,547	403	12,500	658
Japan	26,904	3,305	102,554	11,365
"Other Asia"	16,629	976	20,545	(1,361)
Total All Countries	**$277,509**	**$18,719**	**$481,500**	**$16,273**

Source: U.S. Treasury

German investors remained cool to U.S. equities in 1987. Although these investors were one of few Europeans making net purchases of U.S. equities in the fourth quarter, modest sales countered modest purchases over the year bringing the annual result to net sales of $74 million. In comparison, German investors made net purchases of $341 million in 1986. With the mark one of the strongest currencies vis-a-vis the dollar, these investors evidently were not counting on the U.S. stock market's appreciation outpacing currency depreciation. Nor does it appear that German investors were enthusiastic about their domestic equity market. While the German mark soared, the stock market slumped as the mark's buffeting of the export sector took its toll on economic growth. At the same time, foreign investors kept their distance.

TABLE II

FOREIGN NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1987 First Quarter	1987 Second Quarter	1987 Third Quarter	1987 Fourth Quarter
Europe	$4,682	$3,174	$2,103	$(8,136)
Belgium-Luxembourg	180	130	123	(22)
France	1,242	562	(17)	(878)
Germany	97	(138)	(80)	48
Netherlands	213	476	367	(178)
Switzerland	379	451	30	(2,021)
U.K.	2,419	1,527	1,524	(4,987)
Canada	327	62	189	540
Latin America & Caribbean	1,011	660	732	(1,120)
Bermuda	(15)	(36)	229	(279)
Netherlands Antilles	491	(2)	41	(726)
Asia	3,616	4,390	1,669	1,864
Hong Kong	98	173	359	34
Japan	3,495	4,098	1,923	1,847
"Other Asia"	(270)	(95)	(1,034)	38
Total All Countries	**$9,834**	**$8,653**	**$5,023**	**$(7,236)**

Source: U.S. Treasury
Note: Totals incorporate revised data; country data unrevised.

Given an unusually high amount of net investment in the first half of the year by French investors, net sales of $878 million in the fourth quarter brought net purchases to $903 million, about double 1986's $459 million. After enjoying a revival in recent years fueled by domestic investors, the French stock market had a hard time shaking the doldrums in 1987. Economic problems were exacerbated--slow growth and rising unemployment--by the widening gap in the French trade deficit to $10 billion in 1987 from $2 billion in 1986.

Canadian Investors

Canadian investors were among the few major investors who increased net purchases of U.S. equities in the fourth quarter, by a relatively hefty $540 million. With the addition of fourth-quarter activity, net purchases jumped 37% to $1.1 billion in 1987, from $816 million in 1986. The Canadian stock market and economy enjoyed notable performances in 1987. The Canadian stock market compared to other major markets made a good, if somewhat narrowly based, recovery after October. The Canadian economy grew at a fast pace during the year, with annual growth of over 4%. Moreover, interest rates were retained at relatively high levels, keeping the Canadian dollar steady while attracting a considerable amount of foreign investment. Nevertheless, for broader equity investment opportunities than those available in the domestic market, Canadian investors turned to the U.S

Latin American & Caribbean Investors

Through the first three quarters of 1987, Latin American and Caribbean investors were net buyers of U.S. equities at a pace comparable to 1986. However, given fourth-quarter net sales of $1.1 billion, net purchases in 1987 fell to $1.3 billion compared to $3.0 billion in 1986. Investors in the Netherlands Antilles made the largest fourth-quarter sales in this region, $726 million, and were net sellers of $163 million for the year. Enthusiasm for U.S. equities stemmed mainly from the Bahamas, with net purchases totalling $527 million. In addition, net purchases of over $200 million each originated in Panama and the British West Indies. The safe haven concept remains a major factor in capital flows from this region.

Asian Investors

With the acceleration of Japanese interest in U.S. equities, Asian net purchases of U.S. equities soared to $11.5 billion in 1987 from $4.9 billion in 1986. Japanese investors took the long-held number one spot from British investors as the largest foreign acquirers of U.S. equities. Japanese net purchases of $11.4 billion accounted for 70% of total foreign acquisitions in 1987. This compares with 18% of total foreign buying in 1986. Not only did Japaneses investors take the number one spot in net purchases of U.S. equities, but these investors became the largest purchasers of non-domestic securities in 1987, again surpassing British investors.2/

Given the magnitude of Japanese savings, the shifting pattern of Japanese investment in recent years is revealing. The search for higher returns thanavailable in domestic markets plus liquidity and safety brought about $25 billion of Japanese investment to the U.S. Treasury market in 1984 and 1985. When currency developments began to produce dwindling returns, these investors turned their attention to the rallying U.S. equities market in 1986 and 1987. While the Japanese presence in 1987 brought a hitherto unheard of

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2/ International Capital Markets Review. SIA, forthcoming issue.

amount of foreign annual investment to U.S. equities, there is evidence of another coming shift in investment preferences. The overall level of Japanese long-term investment abroad in 1987, at $133 billion, was little changed from the previous year.3/ However, increases in direct investment and loans were offset by reduced foreign securities purchases.

Foreign Activity in U.S. Corporate Bonds

From the start of the year, it was evident that foreign investors' interest in U.S. corporate bonds was waning from 1986's exceptional level. Moreover, with the turmoil in the financial markets and the declining dollar after the crash, foreign net purchases of U.S. corporate bonds receded from an average $2.2 billion monthly to about $500 million in November and December combined. The pullback after the crash coupled with a lack of Japanese interest in corporate bonds during the year resulted in net purchases of $22.7 billion in 1987, a 48% plunge from 1986's $43.7 billion. With diminished net purchases came lower gross activity, which sunk 20% to $103.2 billion in 1987 from $128.5 billion in 1986.

TABLE III

GROSS TRANSACTIONS IN & NET PURCHASES OF U.S. CORPORATE BONDS

($ Millions)

	1986		1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$ 97,831	$37,747	$ 76,340	$20,333
Belgium-Luxembourg	2,051	(27)	3,125	(312)
France	1,816	256	2,219	210
Germany	8,547	(321)	4,841	(167)
Switzerland	9,588	4,459	6,272	1,683
U.K.	73,550	32,852	55,282	18,413
Asia	20,997	4,437	17,029	485
Japan	12,806	5,083	12,400	518
"Other Asia"	5,381	(1,611)	2,267	(215)
Total All Countries	**$128,454**	**$43,672**	**$103,205**	**$22,703**

Source: U.S. Treasury

3/ "Is Japan adjusting enough?", World Financial Markets, Morgan Guaranty Trust Co., 3/18/88

TABLE IV

FOREIGN NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1987 First Quarter	1987 Second Quarter	1987 Third Quarter	1987 Fourth Quarter
Europe	$6,176	$6,179	$6,696	$1,221
Belguim-Luxembourg	(174)	(39)	76	(170)
France	98	33	54	25
Germany	117	(83)	(16)	(186)
Switzerland	724	352	723	(108)
U.K.	5,300	5,721	5,668	1,656
Asia	1,090	(480)	(384)	189
Japan	1,059	(423)	(271)	153
"Other Asia"	(43)	3	(242)	67
Total All Countries	**$7,687**	**$6,545**	**$6,705**	**$1,767**

Source: U.S. Treasury
Note: Totals incorporate revised data; country data unrevised.

In general, with each jump in U.S. interest rates during the year, foreign investors increased net purchases of corporate bonds as these increases were not matched, for the most part, internationally. For example, despite the dollar's troubles, the 60 basis point increase in corporate bond yields in September precipitated a jump in foreign corporate bond purchases to over $3.0 billion.4/ Nevertheless, yield/dollar considerations kept total foreign investment at a subdued level overall in 1987.

European net purchases of corporate bonds dropped 46% to $20.3 billion in 1987 from $37.7 billion in 1986. The lower level of net purchases stemmed from dampened enthusiasm on the part of U.K. and Swiss investors. While U.K. investors continued to fuel the European level of net acquisitions, U.K. net purchases dropped 44% to $18.4 billion in 1987 from $32.9 billion in 1986. Despite a yield spread which favored U.K. over U.S. bonds, it was not until the fourth quarter that U.K. investors significantly cut their net purchases of U.S. corporate bonds, to $1.7 billion from $5.7 billion in the third quarter. Swiss investors' attraction to corporate bonds also diminished sharply in 1987, with net purchases reduced 62% to $1.7 billion from $4.5 billion in 1986.

Japanese investors departed from the U.S. fixed income markets in 1987, preferring instead the rallying equity market. Given the soaring yen and level of U.S. interest rates, U.S. fixed income instruments did not appeal to these investors who headed for other shores and higher returns. However, after two quarters of net selling, these investors were modest net purchasers, $153 million,

4/ Yield comparisons in this report based on data in World Financial Markets, Morgan Guaranty Trust Co.

in the fourth quarter. For the year, Japanese net purchases of U.S. corporate bonds came to $518 million or about 2% of total foreign net buying. In comparison, these investors acquired $5.1 billion in 1986 or about 12% of total foreign net acquisitions of corporate bonds.

Foreign Activity in U.S. Treasury Bonds & Notes

Foreign activity in U.S. Treasury notes and bonds in 1987 reflects the dollar's troubles during the year. Overall, foreign net purchases increased 34% to $25.9 billion from $19.4 billion in 1986. It is not the magnitude of foreign net activity, which compares with a record $29.2 billion in 1985, but the investor pattern that reveals 1987's story. In 1987, foreign central banks purchased $31.2 billion of Treasuries, while private foreign organizations and individuals sold $154 million. In addition, international and regional organizations were net sellers of $5.1 billion of Treasuries.

The large-scale net purchases by foreign central banks indicate efforts to buoy the dollar in the foreign exchange markets in 1987. While support movements were evident in 1986--central bank net purchases totaled $14.2 billion, the intensification of the dollar's fall coupled with the Louvre Accord brought an intensification of activity in Treasuries. In contrast, foreign private organizations and individuals were major players in the Treasury market in past years. In 1984 and 1985, these investors purchased $16.0 billion and $20.6 billion, respectively. With the expansion of portfolio objectives and the narrowing of

TABLE V

FOREIGN GROSS ACTIVITY AND NET PURCHASES OF U.S. TREASURY NOTES & BONDS
($ Millions)

	1986		1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$678,819	$16,326	$902,616	$23,610
Germany	59,182	7,670	88,186	13,295
Switzerland	46,622	329	28,134	1,925
U.K.	443,746	4,546	601,623	3,955
Asia	819,165	1,345	1,248,319	4,677
Japan	659,252	(22)	1,053,763	877
"Other Asia"	74,441	(1,529)	63,422	(3,111)
Nonmonetary Int'l & Regional Organizations	512,703	(1;103)	292,928	(5,092)
Total All Countries	**$2,149,264**	**$19,388**	**$2,642,154**	**$25,936**

Source: U.S. Treasury

TABLE VI

FOREIGN NET PURCHASES OF
U.S. TREASURY NOTES AND BONDS
($ Millions)

	1987 First Quarter	1987 Second Quarter	1987 Third Quarter	1987 Fourth Quarter
Europe	$8,959	$5,444	$2,594	$6,667
Germany	3,840	3,797	2,441	2,973
Switzerland	1,979	1,701	(275)	(1,428)
U.K.	1,540	(1,031)	(315)	3,721
Asia	(2,068)	2,825	5,444	(1,428)
Japan	(766)	1,081	2,040	(1,494)
"Other Asia"	(1,456)	(341)	(39)	(1,218)
Nonmonetary Int'l & Regional Organizations	172	(2,179)	(4,660)	1,354
Total All Countries	**$6,742**	**$8,575**	**$2,796**	**$7,793**

Source: U.S. Treasury

interest rate differentials, foreign private organizations and individuals broadened their investment horizons to other markets. These foreign investors reduced net acquisition of Treasuries to $6.3 billion in 1986 and swung to net sellers of $154 million in 1987.

Of particular note in recent years is the dramatic acceleration of gross activity in Treasuries. While gross activity in 1987, $2.6 trillion, increased a relatively modest 22% from the 1986 level, gross activity was comparably only $253.9 million in 1983. From 1983 through 1986, foreign gross transactions leaped by over 100% annually on average. The quickened pace of international markets, the increased use of Treasuries as a swap and hedging vehicle, and the stepped up role of central banks in the past two years have accounted for the significant growth of foreign activity in the Treasury market.

The fourth quarter of 1987 was a period of severe downward pressure on the dollar, generated by both interest rate declines and confusion over U.S. economic policy. From 9.80% at the end of September, yields on Treasuries fell 76 basis points to 9.04% by the end of October and finished the year at about 8.95%. Worldwide interest rates declined sharply in the fourth quarter although, in general, not to the extent of U.S. rates. Hence, in addition to economic uncertainty, the fiscal and trade deficits, and press reports of abandonment of official support for the dollar, the U.S. currency had to contend with unfavorable trends in rate differentials.

Of particular interest in the fourth quarter was the activity of private foreign investors. Private foreign organizations and individuals were massive net sellers of Treasuries in October, $8.0 billion. At the same time, foreign activity in the U.S. equity market reveals a holding-firm position. However, when foreign investors left the equity market in November and December, there was an almost offsetting flow of funds to Treasuries. All interest rates in the U.S. fell sharply after the stock market decline, as investors shifted back into fixed interest rate securities, particularly Treasury bills and bonds.5/ Both domestic and foreign investors sought the safety and soundness of the Treasury market after the crash as they pursued a "flight to quality."

European net purchases jumped in the fourth quarter to $6.7 billion, as private organizations and individuals sought safety and central banks joined U.S. authorities in attempts to prop up the dollar. Net purchases stemming from Germany amounted to $3.0 billion. The strong German mark was the subject of policy negotiations between U.S. and German authorities. Although authorities often did not agree on initiatives, the German central bank was a major supporter of the dollar in foreign exchange markets, as reflected in net purchases of $13.3 billion of Treasuries compared with $7.7 billion in 1986. While the British pound was subject to a bit of buffeting during the year, net purchases of $4.0 billion were made, down only slightly from $4.5 billion in 1986. Although net sales of $1.4 billion stemmed from Switzerland in the fourth quarter, activity in 1987 resulted in an increase in net purchases to $1.9 billion from $329 million in 1986.

Asian investors made net sales of $1.4 billion in the fourth quarter, bringing total activity for the year to net purchases of $4.7 billion. The shift by Japanese investors to the equity market has resulted in greatly diminished net purchases of Treasuries. Central bank support operations were offset by the activity of private organizations. Japanese net purchases of Treasuries were $877 million in 1987, compared to net sales of $22 million in 1986. Another past enthusiastic buyer of U.S. Treasuries, the oil-exporting countries, continue to make large divestitures. With the swing in the fortunes of oil exporters in recent years, these countries have generally drawn down reserves in U.S. dollar-denominated assets. Net sales of $3.1 billion were made in 1987 and $1.5 billion in 1986.

Activity stemming from two other Asian countries which are usually not major factors in the Treasury market was notable in 1987. Investors located in Singapore made large net sales of $3.8 billion of Treasuries, and investors located in Taiwan made net purchases of $9.8 billion (not shown in tables). The large net purchases are reflective of Taiwan's central bank's efforts to hold down the value of its currency. However, toward the end of the year, in light of the U.S. trade deficit, the U.S. was attempting to convince Taiwan policymakers to allow a quicker appreciation of the Taiwan dollar.

5/ Quarterly Review, Federal Reserve Bank of New York, Winter 1987-88.

U.S. Investor Activity in Foreign Stocks

Net divestitures of foreign stocks by U.S. investors in the fourth quarter undermined what was basically a favorable U.S. view of foreign investment during much of 1987. Large net sales of $3.7 billion in the fourth quarter washed out first-half net purchases leaving net sales of $1.4 billion for the year. This compares with net purchases of $2.4 billion in 1986. A close look at 1987, however, shows that U.S. investors paid considerable attention to European and Canadian stocks while making massive net divestitures of Japanese stocks.

Not unlike the 1986 pattern, there was a marked increase in the magnitude of investment funds involved. U.S. gross transactions in foreign stocks, $187.0 billion, raced 84% past the 1986 record, $101.5 billion. Were it not for a sharp curtailment in activity after the crash, gross transactions in 1987 would easily have made it to the $200.0 billion mark.

TABLE VII

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1986		1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$55,250	$2,038	$101,028	$3,188
France	4,007	471	5,986	(160)
Germany	6,128	472	8,885	(453)
Netherlands	3,777	(451)	5,148	52
Switzerland	3,218	296	6,288	732
U.K.	32,585	1,319	67,650	3,014
Canada	9,837	1,077	17,416	2,132
Asia	30,075	(931)	56,154	(7,412)
Japan	25,618	(1,400)	47,434	(6,508)
Other	6,372	176	12,442	670
Total All Countries	**$101,534**	**$2,360**	**$187,040**	**$(1,422)**

Source: U.S. Treasury

TABLE VIII

NET PURCHASES OF
FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1987 First Quarter	1987 Second Quarter	1987 Third Quarter	1987 Fourth Quarter
Europe	$1,104	$1,941	$ 925	$ (782)
France	40	4	(27)	(177)
Germany	(194)	203	115	(577)
Netherlands	193	281	(74)	(348)
Switzerland	(33)	157	257	351
U.K.	1,277	888	353	496
Canada	904	696	566	(34)
Asia	(593)	(2,190)	(1,663)	(2,966)
Japan	(351)	(2,004)	(1,398)	(2,755)
Other	(91)	258	106	76
Total All Countries	**$1,550**	**$794**	**$(60)**	**$(3,706)**

Source: U.S. Treasury
Note: Totals incorporate revised data; country data unrevised.

Despite an underweighting of Japanese stocks in U.S. portfolios, U.S. investors were taking no chances in the Japanese market in 1987. Net sales escalated to $6.5 billion from $1.4 billion in 1986. However, the Japanese market staged a prompt recovery from the crash, returning over 43% by year's end in dollar terms. Uncertainty about the impact of the appreciating yen on the Japanese economy kept U.S. investors cautious. But, a quicker-than-expected adjustment to the rising yen and a pickup in domestic demand have put the Japanese economy back on a fast track. The Japanese stock market is also again on a fast track and starting to attract increased foreign interest after an apparent incorrect assessment of stock price trends by foreign investors.

The strong rise of the mark against the dollar was not enough to make up for the steep fall of the German stock market from year-end 1986 to year-end 1987. Nevertheless, U.S. investors made moderate purchases of German stocks in midyear, as the German stock market began to recover from a first-quarter slide. However, with the German market suffering one of the worst October falloffs, U.S. investors made net sales of $577 million. U.S. investors were reportedly not the only foreign sellers of German stocks in the fourth quarter, as total foreign sales came to DM7 billion in that quarter compared to purchases of DM15 billion

in all of 1986.6/ U.S. net sales came to $453 million in 1987, in contrast to net purchases of $472 million in 1986. Similarly, the French market did not have a good year, even translated into dollar terms. U.S. interest in French stocks was minimal over much of the year and fourth-quarter net sales came to $177 million. Net sales were $160 million in 1987, in contrast to net purchases of $471 million in 1986.

The Canadian market was steaming ahead, up over 30% at September's end, along with the Canadian economy until the October slowdown. Surging gold mining and natural resource related stocks led the rallying market, while the Canadian economy was fueled by strong growth in the U.S. and firming energy prices. Although U.S. investors sold Canadian stocks in the fourth quarter--a modest $34 million, net purchases for the year totaled a record $2.1 billion, just about double 1986's $1.1 billion.

Although all international investors retreated to home markets in the fourth quarter, we view this as only a temporary setback in the process of internationalization. U.S institutional portfolios are underweighted in foreign stocks relative to the composition of foreign institutional portfolios. U.S. pension funds have only about 4% of their total assets invested globally, while U.K. and Japanese pension funds have globally invested 30% and 10%, respectively, of their total assets.7/ This indicates that U.S. portfolio managers will continue to seek investment opportunities overseas. Moreover, the shifting of worldwide income and wealth that has led to a less dominant position for the U.S.--the U.S. had 47% of world GNP in 1970 and 39% in 1986--will serve to prod international portfolio diversification.

Carolyn Hildebrandt
Assistant Vice President &
Director of Macroeconomic
Studies

6/ "Where have all the foreigners gone?", The Economist, 3/12/88.

7/ "Investing Overseas: Opportunities & Challenges," Dave Williams, Transcript of International Capital Markets: Opportunities & Challenges, 10/87.

SIA

Foreign Activity

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Foreign Activity in U.S. Securities
"Highlights"

1. With negative sentiment plaguing the stock market and dollar in the first quarter of 1988, foreign investors made net sales of $761 million of U.S. equities, compared with net sales of $7.3 billion in the fourth quarter. Foreign investors have not been consecutive quarterly net sellers of U.S. equities since the first quarter of 1985, which followed three quarters of selling in 1984.

2. Japanese investors continued to support U.S. equities, with net purchases of $1.1 billion in the first quarter. Hence, Japanese investors retained their newly acquired title of largest foreign buyers of U.S. equities.

3. The dollar showed modest strength in April and May, but the U.S. stock market remained in the doldrums. Preliminary data indicate that net selling of U.S. equities by foreign investors continued in these two months.

4. Although first-quarter foreign net purchases of U.S. corporate bonds totaled $2.3 billion, this amount was just about the same as the pre-crash monthly average.

5. Intervention activity coupled with renewed interest by private foreign investors pushed foreign net purchases of U.S. Treasuries to $26.7 billion in the first quarter -- 4% more than net purchases for all of 1987.

6. U.S. investors made net purchases of $883 million of foreign stocks in the first quarter. Hence, with foreign investors selling U.S. equities and U.S. investors making modest purchases of foreign stocks, equity capital flows were reversed from the traditional pattern of past periods.

7. After making large net sales of Japanese stocks in 1987, U.S. investors were net buyers of $1.0 billion in the first quarter. However, with the dollar gaining on the yen in the second quarter and the Japanese market already past its pre-crash peak, it remains to be seen if international portfolio managers have called the Japanese market correctly in 1988.

Overview

The October market collapse put a quick end to foreigners' attraction to U.S. equities in 1987. The two main considerations for foreign investment, stock prices and the dollar, were left with very uncertain futures in the wake of the October crash. From end-October to year-end, the DJI Average backtracked by 3% and the dollar plunged by 15-20% in the foreign exchange markets. While net sales of $9.7 billion of U.S. equities in the final two months of the year halted 1987's climb to a record, foreign net purchases of U.S. equities still totaled a hefty $16.2 billion. At this level, foreign investment in 1987 missed upsetting the 1986 record, $18.7 billion, by only 13% and far surpassed previous levels of foreign portfolio investment. Generally negative sentiment plagued the stock market and dollar in the first quarter of 1988, prompting foreign investors to keep their distance. Foreign net sales of $761 million of U.S. equities were made in the first quarter, compared to the fourth-quarter's large divestitures of $7.3 billion. Foreign investors have not been consecutive quarterly net sellers of U.S. equities since the first quarter of 1985, which followed three quarters of net divestitures in 1984.

The U.S. stock market was not to offer investors, domestic or foreign, much encouragement in the way of improved performance in the first quarter. In the first month of the year, worries persisted that the health of the U.S. economy was fragile, leading the Federal Reserve to ease interest rates. However, that scenario came full circle, as data began to accumulate that economic growth was stronger than expected and inflationary expectations developed. First-quarter real GNP growth did eventually prove to be a robust 3.6% annual rate. Fears of an overheating economy hovered over the stock market, allowing only a limited and slow climb in February. Increases in gold and oil prices fired up inflationary fears in March and the upward trend of interest rates gained momentum. Although the market retreated in March from its February close, modest progress was posted in the first quarter from year-end. The DJI Average gained almost 5%, while the NYSE composite increased 7%.

The U.S. dollar fared little better than the U.S. stock market in the first quarter. Massive central bank intervention at the beginning of the year was necessary to bring the dollar back from the skids. In addition, the aggressive posture of the central banks signaled the power of joint intervention to the foreign exchange markets. While the dollar benefited from good news early in the quarter -- a shrinking of the trade deficit as well as a united front on foreign exchange stability between the U.S. and Japan, the dollar's gains were eroded

somewhat in March. Questions arose as to the G-7 commitment, inflationary pressures in the U.S., and future improvement in the trade deficit. Nevertheless, the dollar gained against four of the major currencies in the first quarter, with gains ranging from over 2% vis-a-vis the yen to almost 7% against the Swiss franc. Riding on the crest of high interest rate, the Canadian dollar advanced by 5% against the dollar and the British pound edged up.

Foreign investors did not venture far into the U.S. financial markets in the first quarter of 1988. While shunning equity investment, these investors showed little interest in corporate bonds. On the other hand, private foreign investors continued to favor U.S. Treasuries, an investment which garnered renewed respect in the backlash of the crash. Moreover, although the dollar showed a bit of strength in April and May, the U.S. stock market remained mired in the doldrums. Preliminary data indicate that foreign investors continued to make net sales of U.S. equities in these two months.

Foreign Activity in U.S. Equities

Gross Activity

Foreign gross activity in U.S. equities escalated to a record $481.9 billion in 1987, driven by the new found interest of Japanese investors in U.S. equities. With the waning of foreign acquisitions of equities in the first quarter came a waning of gross transactions. From a slightly escalated clip of $122.2 billion in the fourth quarter, gross transactions dropped 22% to $95.4 billion in the first quarter of 1988.

All countries reduced gross activity in U.S. equities. European investors cut back gross activity the sharpest, 30% to $41.4 billion from $58.9 billion in the fourth quarter. Canadian and Latin American and Caribbean investors reduced activity by 24% each to $7.6 billion and $9.0 billion, respectively. Since Japanese gross transactions fell only a shade from the fourth-quarter level, gross activity by all Asian investors declined by a modest 9% to $35.5 billion in the first quarter.

Net Purchases

Foreign net purchases of U.S. equities stood at about $25.9 billion at the end of October. In the aftermath of the market collapse, foreign investors fled the equity market, with fourth-quarter net divestitures totaling $7.3 billion. Although the "panic" selling of equities subsided in the first quarter to $761 million, it is clear foreign investors preferred to sit on the sidelines.

TABLE I

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ MILLIONS)

	Fourth Quarter 1987		First Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$ 58,895	($8,139)	$41,416	$ (908)
Belgium-Luxembourg	2,826	(22)	2,219	76
France	5,880	(876)	3,342	(132)
Germany	3,891	47	2,795	201
Netherlands	2,920	(178)	2,050	(236)
Switzerland	13,822	(2,022)	9,103	(399)
United Kingdom	26,986	(4,991)	19,681	(599)
Canada	10,080	533	7,618	(80)
Latin America & Caribbean	11,838	(1,124)	8,971	217
Bermuda	2,337	(280)	1,677	(9)
Netherlands Antilles	4,239	(730)	2,822	77
Asia	39,174	1,864	35,542	(130)
Hong Kong	3,530	34	1,975	(180)
Japan	29,865	1,847	28,936	1,072
"Other Asia"*	4,388	38	3,597	(933)
Total All Countries	**$122,229**	**$(7,250)**	**$95,358**	**$(761)**

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

European Investors

The escalated net divestitures of U.S. equities, $8.1 billion, after the crash by European investors almost wiped out net purchases made in the first three quarters of 1987, about $10.0 billion. Although the amount of net sales receded dramatically to $908 million in the first quarter, most major European investors remained net sellers of U.S. equities. Net selling by U.K., Swiss and French investors fell off sharply from the heightened fourth-quarter level. German investors, the only major European net buyers of U.S. equities in the fourth quarter, boosted net purchases to $201 million in the

first quarter from $47 million. In addition, investors located in the Belgium-Luxembourg countries swung to net buyers of $76 million from net sellers of $22 million in the last quarter of 1987.

Just as U.K. investors were the largest European buyers of U.S. equities in the first three quarters of 1987, they were also the largest sellers in the fourth quarter, $5.0 billion. In the first quarter of 1988, U.K. investors retained the title of the largest European sellers of U.S. equities, albeit net sales dropped to $599 million. U.K. investors most likely focused on domestic fixed income markets or other foreign markets, as the U.K. stock market inched up marginally in the first quarter.1/ U.K. interest rates were relatively high in the first quarter, lending the pound exceptional strength. With the U.K. economy posting strong growth and setting off fears of overheating, there was little chance of U.K. interest rates falling, leading to substantial capital inflows.

Like their U.K. counterparts, Swiss investors were significant net sellers of U.S. equities in the fourth quarter, $2.0 billion. These investors continued to divest equities in the first quarter but at a sharply reduced pace, $399 million. The Swiss stock market managed a slightly better performance than the U.S. market in the first quarter. In addition, the Swiss franc has been subject to upward pressure as the "haven" currency against the dollar and volatile securities markets since the crash.2/ The Swiss central bank has acted to ease the franc's position, lest currency appreciation damage the export-oriented economy. Over the quarter, the franc lost 7% against the dollar.

French investors also reduced their large fourth-quarter net divestitures, $876 million, to $132 million in the first quarter. However, it is unlikely that these investors turned to their domestic stock market, which barely budged over the first quarter. The French stock market's bull run ended mid-1987, setting the stage for a particularly severe October setback. The new year started with yet another weight on the French market -- speculation over the May election and Mitterrand's proposals to reimpose a wealth tax and halt the French privatization program.

1/ Stock market comparisons based on Morgan Stanley Capital International Perspective.

2/ "A time for change but slowly", Forbes, June 13, 1988.

Canadian Investors

Canadian investors were whole-hearted supporters of U.S. equities in 1987, making net purchases of $1.1 billion. The first-quarter turnabout by these investors, net sales of $80 million, represents the first time these investors have been net sellers of U.S. equities since the end of 1985. Given a soaring Canadian dollar and comparably high-yielding domestic securities, Canadian investors remained at home in the first quarter.

Latin America & Caribbean Investors

Investors from this region were steady purchasers of U.S. equities in 1987 until swinging to net sellers of $1.1 billion in the fourth quarter. In the first quarter, these investors resumed their net buying of U.S. equities with net purchases totaling $217 million. Buying interest was limited and stemmed mainly from only two countries. Investors located in the Netherlands Antilles and the British West Indies made net purchases of $77 million and $95 million, respectively.

Asian Investors

Bolstered by the hefty appetite of Japanese investors for U.S. equities, Asian net purchases of U.S. equities skyrocketed to $11.5 billion in 1987. In the fourth quarter, strong Japanese buying in October outweighed comparably modest net sales in the final two months of the year. Hence, Japanese investors were the largest net buyers of U.S. equities both for the year and in the fourth quarter, $1.8 billion. In the first quarter of 1988, although Japanese investors were once again the largest foreign buyer of U.S. equities, $1.1 billion, net selling by the other two major Asian countries offset Japanese interest. Investors in Hong Kong and the oil-exporting countries were net sellers of $180 million and $933 million, respectively. Activity by the Asian countries in the first quarter resulted in net sales of $130 million.

While Japanese investors were clearly the most enthusiastic foreign supporters of U.S. equities in the first quarter of 1988, their enthusiasm waned from the heightened 1987 quarterly levels. Even before the October market collapse, there was evidence that Japanese capital outflows to foreign securities markets were dwindling. With the 25% jump of their domestic stock market, Japanese investors may have been content to stay at home. Spurring the stellar rise of the Japanese stock market were both economic fundamentals and government policy changes supportive of stock investing. For example, the central bank has followed an accommodative monetary policy both to lower the yen against the dollar and to keep short-term interest rates low. In addition, after a two years respite, foreign investors returned to the Japanese stock market.

Foreign Activity in U.S. Corporate Bonds

With Japanese investors showing little inclination toward U.S. corporate bonds in general and a sharp retreat by foreign investors after the crash, foreign net acquisitions of U.S. corporate bonds in 1987 totaled $22.7 billion, about half the prior year's record level. Foreign investors retained their post-crash sentiment toward corporate bonds in the first quarter of 1988. In the fourth quarter of 1987, foreign net purchases dwindled to only $1.7 billion and activity in November and December combined was less than $500 million. Although first-quarter 1988 foreign net purchases of corporate bonds recovered 33% to $2.3 billion, 1987 pre-crash monthly purchases averaged just that. The first quarter's modest increase was not evenly paced, as 70% of net purchases stemmed from activity in March when yields spurted by 40 basis points.

Interest rates in the U.S. trended down in general in January. However, data accumulated that the economy was in better shape than anticipated after the crash. Inflationary expectations coupled with a general investor reluctance to commit to long-term investments worked to push interest rates higher. Consequently, despite a 52 basis point drop in January to 9.38% from 9.90% at year-end 1987, U.S. corporate bond yields rose modestly in February and spurted 40 basis points in March to end the first quarter at 9.85%.[3/] At the end of the period, yields on corporate bonds in most major countries declined by considerably more than the modest drop in U.S. corporate bond yields.

Based mainly on a reversal in investment position by German investors, European investment in U.S. corporate bonds was boosted by 43% to $1.7 billion in the first quarter from $1.2 billion in the fourth quarter. German investors swung to net purchases of $231 million from net sellers of $186 million in the fourth quarter. However, the major foreign player in the U.S. corporate bond market remained lukewarm. U.K. investors made net purchases of $1.5 billion in the first quarter, compared with average net acquisitions of over $5 billion in the first three quarters of 1987. Although the yield differential between U.K. and U.S. corporate bonds narrowed, U.K. yields remained in the double-digits and the pound was one of the strongest currencies vis-a-vis the dollar. Other European investors appear to have taken a slightly more favorable position on U.S. corporate bond investment than in the fourth quarter.

3/ Interest rate comparisons based on data in World Financial Markets, Morgan Guaranty Trust Company of New York.

TABLE II

GROSS TRANSACTIONS IN AND NET PURCHASES OF
U.S. CORPORATE BONDS
($ MILLIONS)

	Fourth Quarter 1987		First Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$15,292	$1,187	$12,802	$1,700
Belgium-Luxembourg	1,114	(170)	581	(108)
France	419	24	695	71
Germany	1,146	(186)	1,059	231
Switzerland	1,252	(108)	1,044	(59)
United Kingdom	10,306	1,623	8,699	1,521
Asia	3,889	189	4,737	190
Japan	2,895	153	3,813	287
"Other Asia"	422	67	569	(111)
Total All Countries	$21,494	$1,733	$20,554	$2,304

Source: U.S. Treasury

Asian net purchases of U.S. corporate bonds in the first quarter were unchanged from the fourth-quarter 1987 level, $190 million. Japanese investors turned a cold shoulder to U.S. corporate bonds in 1987, making net purchases of $518 million. However, these investors were net purchasers of $153 million in the fourth quarter and boosted net purchases by 88% to $287 million in the first. First-quarter Japanese activity was offset by net sales of $111 million of corporate bonds by the oil-exporting countries.

Foreign Activity in U.S. Treasury Bonds & Notes

Foreign activity in U.S. Treasury bonds and notes in 1987 attests to the dollar's troubles and central bank efforts to temper the dollar's fall. Of the $25.8 billion in foreign net purchases of Treasuries in 1987, $31.2 billion was acquired by foreign central banks. Central bank activities offset net sales of $131 million by private foreign investors (institutions and individuals) and $5.3 billion by international and regional organizations. In the two months following the crash, however, private foreign investors who had diversified out of Treasuries during 1987 and 1986 made net purchases of $8.3 billion.

With accelerated central bank intervention and the continuation of a "flight to quality" psychology by private foreign investors, the foreign investment pattern in Treasuries in the first quarter mirrors the fourth. In magnitude, however, net purchases escalated to $26.7 billion in the first quarter, 4% more than 1987's total. To bring the dollar back from record lows, central banks made net purchases of $20.3 billion of Treasuries. Private foreign investors sought Treasuries for U.S. dollar-denominated investment, with net purchases totaling $7.3 billion. International and regional organizations sold $896 million of Treasuries in the first quarter.

Net purchases of $13.4 billion of U.S. Treasuries stemmed from Europe in the first quarter. Given that the German mark was one of the major currencies against which the dollar plummeted to a record low, the $5.4 billion of net purchases most likely reflected mainly central bank support of the dollar. Likewise, the fourth quarter saw sterling soar 16% against the dollar. Rising oil prices coupled with comparably high U.K. interest rates continued to fuel sterling's rise over the first quarter. U.K. net purchases of $4.0 billion of Treasuries also most likely reflected central bank intervention. Contributing to the heightened level of European activity were net purchases of over $1.0 billion originating from the Belgium-Luxembourg countries.

Massive net purchases of $12.3 billion of Treasuries stemmed from Japan in the first quarter. The Japanese authorities had confirmed their intention to aid the dollar and accounting practices peculiar to Japanese insurance companies also made it advantageous to buoy the dollar. Hence, supported by data from Japanese sources, we believe Japanese private buyers were also relatively large purchasers of Treasuries in the first quarter, particularly at the February quarterly refunding. In that month, Japanese capital outflows to foreign securities markets escalated sharply coinciding with a sharp escalation of net purchases of Treasuries, $5.0 billion, by private foreign

TABLE III

NET FOREIGN PURCHASES OF
U.S. TREASURY NOTES AND BONDS
($ Millions)

	Full Year 1987 Net Purchases	Fourth Quarter 1987 Net Purchases	First Quarter 1988 Net Purchases
Europe	$23,611	$ 6,667	$13,380
Germany	13,295	2,973	5,358
Switzerland	1,925	(1,429)	(558)
United Kingdom	3,955	3,721	4,013
Asia	4,707	(1,399)	12,270
Japan	877	(1,494)	12,305
"Other Asia"	(3,111)	(1,218)	(377)
Nonmonetary Int'l & Regional Organizations	(5,302)	1,354	(896)
Total All Countries	**$25,755**	**$7,823**	**$26,688**

Source: U.S. Treasury

investors. Nevertheless, contrary to speculation that the dollar would resume a downward course after March as Japanese private support ended, the dollar held firm against the yen in April.

U.S. Investor Activity in Foreign Stocks

Steady and large net divestitures of Japanese stocks coupled with fourth-quarter net sales swung U.S. investor activity in foreign stocks to net sales of $1.1 billion in 1987. With several foreign stock markets more resilient than the U.S. market and the dollar's course uncertain, U.S. investors cautiously returned to foreign markets in the first quarter of 1988. Net purchases of $883 million of foreign stocks were made, in contrast to net sales of $3.6 billion in the fourth quarter. Hence, with U.S. investors making relatively modest purchases of foreign stocks and foreign investors divesting U.S. equities, the pace of globalization distinctly slowed in the first quarter.

First-quarter U.S. gross activity in foreign stocks subsided from the record pace of 1987. At an all-time high of $189.3 billion, U.S. transactions in foreign stocks averaged about $47.3 billion quarterly. In the first quarter gross transactions sank to $35.7 billion, a 25% drop from the 1987 average.

U.S. investors made massive divestitures of $6.5 billion of Japanese stocks in 1987, following net sales of $1.4 billion in 1986. However, U.S. investors reportedly along with other foreign investors, changed their tune on Japanese stocks in the first quarter of 1988. High-flying P/E ratios and a renowned volatility had kept foreign investors wary of Japanese stocks. But, when the Japanese market bounced back impressively after the crash, the underweighting of Japanese stocks took its toll on foreign fund portfolios. Stock market performance, a relatively stable yen/dollar relationship, and good economic fundamentals hastened the return of U.S. investors to the Japanese market in the first quarter. Net purchases totaled $1.0 billion. However, with the dollar gaining on the yen in the second quarter and the Japanese market at an already exceptional level, it remains to be seen if international portfolio managers have called the Japanese market correctly in 1988.

Propelled by exceptional interest in U.K. stocks, U.S. investors' net purchases of European stocks rose to a record $3.2 billion in 1987. For the first quarter of 1988, U.S. investors made net purchases of $83 million of European stocks, compared with fourth-quarter net sales of $782 million. While U.S. investors returned to European stock markets in the first quarter, their reversed investment position in U.K. stocks served to damp overall net purchases.

U.S. investors paid considerable attention to U.K. stocks in 1987, with net purchases of $3.0 billion comprising almost 95% of total European buying. Moreover, despite the halt of the U.K. market's notable rally about mid-year, U.S. investors remained positive on U.K. stocks throughout 1987. In the first quarter of 1988, high U.K. interest rates sent the pound flying and the U.K. market remained in the doldrums. U.S. investors swung to net sellers of $484 million of U.K. stocks from net purchasers of $496 million in the fourth quarter. U.S. investors pulled back from German stocks in the fourth quarter and made comparably large net sales of $577 million. With a sluggish growth forecast for the German economy in 1988 and the stock market underperforming the U.S. market in dollar terms, U.S. investors continued to make net sales of German stocks, $126 million in the first quarter.

TABLE IV

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ MILLIONS)

	Fourth Quarter 1987		First Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$25,848	$ (782)	$17,343	$ 83
France	1,531	(177)	816	96
Germany	1,977	(577)	1,140	(126)
Netherlands	1,160	(348)	841	67
Switzerland	1,797	351	1,218	540
United Kingdom	17,732	496	12,028	(484)
Canada	3,788	(34)	3,273	(73)
Asia	14,382	(2,966)	13,006	902
Japan	12,351	(2,755)	11,899	1,013
Other	3,274	148	2,043	(29)
Total All Countries	$47,292	$(3,634)	$35,665	$883

Source: U.S. Treasury
Note: Fourth quarter total revised; country data unrevised.

The Swiss market picked up in the first quarter and U.S. investors continued to view Swiss stocks favorably. Net purchases of $540 million were made, a 54% increase from fourth-quarter purchases of $351 million. First-quarter activity in the Swiss market was reportedly focused on a limited number of shares, the recipients of encouraging corporate reports, and marked by frequent profit taking.[4/] Despite showing little interest in 1987, U.S. investors were also net purchasers of $96 million of French stocks in the first quarter. Foreign investors in general began showing some interest in French stocks early this year, tempted by arguments that prices were cheap and price/earnings ratios low.[5/]

4/ "Switzerland", Financial Times Survey, 4/25/88.
5/ "Les Miserables at the Bourse de Paris," The Economist, 4/2/88.

From all appearances, the Canadian economy's strong 1987 growth has continued. Forecasts call for economic growth of 3% or better in 1988. Nevertheless, although the Canadian stock market would have returned over 9% to U.S. investors in the first quarter, net sales of $73 million were made. Canadian interest rates were maintained at a comparably high level, in part to give the Canadian dollar a boost early in the quarter and in part to retain inflationary pressures. The Canadian dollar and high-yielding Canadian securities reportedly attracted considerable foreign inflows in the first quarter. U.S. investors may have focused on fixed income Canadian investments rather then equities.

Carolyn Hildebrandt
Assistant Vice President &
Director of Macroeconomic
Studies

SIA

Foreign Activity

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Produced by the SIA Research Department

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Securities Industry Association
120 Broadway
New York, New York 10271

Phone (212) 608 - 1500

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UPDATE ON
FOREIGN ACTIVITY IN U.S. EQUITIES

Foreign Investors.., A fixed income focus

A "good news is bad news" syndrome dominated stock market activity in the second quarter. Signs of continuing economic growth were interpreted as "bad news", increasing investors' fears of an overheating economy. The obsession with inflationary signals added to pressure on long-term interest rates, while the Federal Reserve allowed short-term rates to rise. Interest rates also trended up in most major countries. Part of the global increase was to temper the rise of the dollar, which developed muscle of its own in the second quarter. Indeed, central banks appear to have reversed their strategy from one of boosting the dollar to one of moderating its climb. Overall, the stock market gained a modest 5% on dismal volume, while the dollar advanced against most key currencies. Hence, after two quarters of net divestitures, foreign investors "tested" the U.S. equity markets in the second quarter, albeit with a minimum of enthusiasm. Foreign investors were net purchasers of $588 million of U.S. equities in the second quarter, in contrast to net sellers of $759 million in the first quarter.

While total foreign investment turned positive on U.S. equities, the second-quarter position results mainly from net purchases of $1.5 billion by Japanese investors. In 1H88 foreign investors' activity in U.S. equities resulted in net sales of $171 million, a striking comparison with net purchases of almost $19.0 billion in 1H87.

Similar to the first quarter, gross activity in the second quarter was at a subdued pace, $96.8 billion. At $192.4 billion for 1H88, gross foreign transactions in U.S. equities are running about 14% less than 1H87's $222.8 billion.

However, foreign investors continued to show interest in U.S. fixed income investment. U.S. Treasuries attracted $3.9 billion of foreign private capital investment (institutions and individuals) in the second quarter, compared to $7.2 billion in the first quarter. While net investment in

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	First Quarter 1988		Second Quarter 1988	
	Gross Activity	Net Purchases[1/]	Gross Activity	Net Purchases
Europe	$41,416	$ (908)	$38,383	$ (637)
Belgium-Luxembourg	2,219	76	2,006	151
France	3,342	(132)	2,896	(33)
Germany	2,795	201	2,831	2
Netherlands	2,050	(236)	1,388	(244)
Switzerland	9,103	(399)	8,984	(468)
United Kingdom	19,681	(599)	18,097	(137)
Canada	7,618	(80)	8,733	171
Latin America & Caribbean	8,971	217	9,634	32
Bermuda	1,677	(9)	1,795	31
Netherlands Antilles	2,822	77	3,244	73
Asia	35,542	(130)	37,807	1,063
Hong Kong	1,975	(180)	1,796	(40)
Japan	28,936	1,072	31,320	1,544
"Other Asia"*	3,597	(933)	3,340	(463)
Total All Countries	**$95,358**	**$(759)**	**$96,758**	**$588**

Source: U.S. Treasury
* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates
1/ Total revised.

Treasuries fell on a quarterly basis, foreign investors' net purchases of corporate bonds picked up to $6.6 billion from $2.3 billion in the first quarter.

U.S. Investors... Headed home again

After making net purchases of $891 million in the first quarter, U.S. investors swung to net sellers of $1.2 billion of foreign stocks in the second. First-quarter net purchases, however, were based largely on U.S. investors' attempts to catch the soaring Japanese market. As the Japanese market took a breather in the second quarter, U.S. investors swung to net sellers of $444 million of Japanese stocks. In addition, net divestitures of $299 million of European stocks were made. For 1H88, U.S. investors were net sellers of $292 million of foreign stocks compared with net purchases of about $2.3 billion in 1H87.

Carolyn Hildebrandt
Assistant Vice President &
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Phone (212) 608 · 1500

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Foreign Activity in U.S. Securities
"Highlights"

1. While foreign investment in U.S. equities in the second quarter turned positive -- net purchases of $588 million contrasting with net sales of $759 million in the first quarter, the swing resulted mainly from continued interest in U.S. equities by Japanese investors. For the first half of 1988, foreign investors made net sales of $171 million contrasting sharply to net purchases of almost $19.0 billion in the first half of 1987.

2. Preliminary Treasury data indicate that foreign investors were net purchasers of $824 million of U.S. equities in July and SIA data indicate these investors were probably net buyers in August also, which coupled with June would make for a three-month buying trend.

3. Gross foreign activity is down about 14% in first-half 1988 as compared with first-half 1987, while the value of share activity on the NYSE is off by about 22%. Hence, it would appear that the foreign sector has fallen off less than the domestic sectors of the market.

4. Second-quarter foreign net purchases of U.S. corporate bonds sprinted to $6.6 billion from $2.3 billion in the first quarter. Nevertheless, first-half 1988 net purchases of $8.9 billion are 37% lower than first-half 1987 acquisitions of $14.2 billion.

5. Foreign acquisition of U.S. Treasuries dropped to $12.2 billion in the second quarter from $26.7 billion in the first because less central bank intervention was needed to support the dollar.

6. U.S. activity in foreign stocks in the first half of 1988 resulted in net sales of $292 million, compared to net purchases of $2.3 billion in first half 1987. However, SIA's Global Equity Analysis shows that investors in the first half of 1988 appear ready to commit new funds to foreign markets.

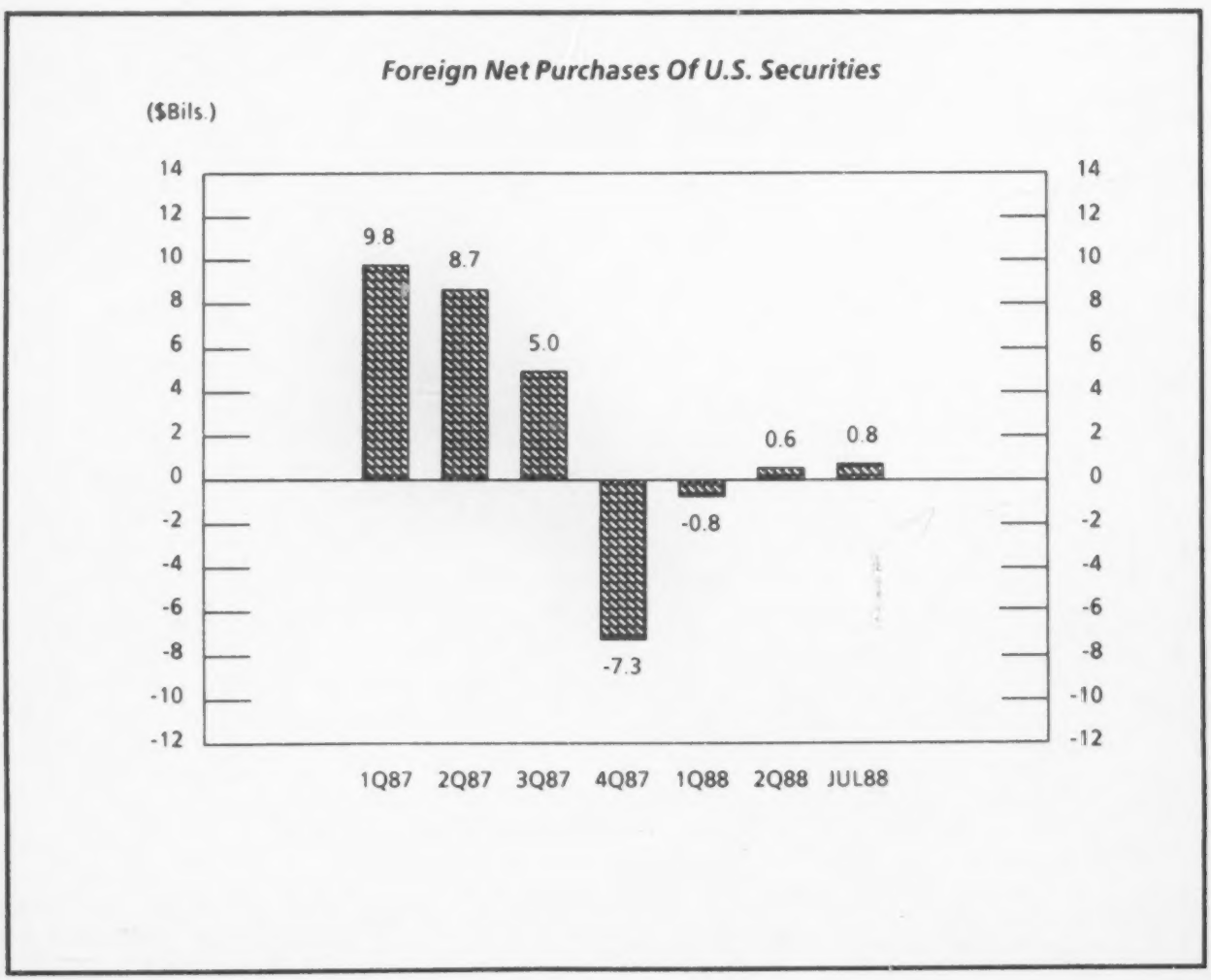
Overview

Foreign investors, like domestic investors, have taken a cautious approach to U.S. equity investment in 1988. The U.S. stock market's climb has been slow and modest, with volume levels on various exchanges down between 10% and 20%. After an auspicious start, the dollar has generally strengthened on increases in U.S. interest rates, strong economic growth and an improving trend in the trade deficit. With the stock market inching forward and the dollar moving higher, foreign investment in U.S. equities swung from net sales of $759 million in the first quarter to net purchases of $588 million in the second quarter. However, the positive foreign investment posture resulted mainly from interest by Japanese investors. The lack of enthusiasm by foreign investors for U.S. equities in the first half of 1988, net sales of $171 million, is made all the more dramatic when compared to net purchases of almost $19.0 billion in the first half of 1987.

U.S. stocks made progress in the first half of 1988 -- the DJI Average gained 11%, the NYSE composite about 12% and smaller capitalized companies increased at almost twice this pace. However, investors' obsession with an inflationary scenario knocked any enthusiasm out of both stock and bond market activity. Signs of continued economic growth, such as declining unemployment, reinforced forecasts of an overheating economy bumping against capacity constraints. While GNP data confirmed the economy had considerable steam -- real annual growth of 3% and better in the first and second quarters, the uptick in price indices in the second quarter was not enough to indicate that inflation was on the verge of spurting out of control. Nevertheless, interest rates in the U.S. moved up in the first half of the year, largely to dampen inflationary fears while bolstering the dollar as well. Globally, interest rates also trended up, but most major markets enjoyed a heartier rise than the U.S. market in the first half of the year.

Over the second quarter, the dollar gained on the uptrend in U.S. interest rates as well as expectations that strong economic growth would lead to a further increase in interest rates. The dollar appreciated between 4% and 6% against the French franc, German mark and Swiss franc. Against the Canadian dollar and Japanese yen, the dollar was little changed. Over the first six months of the year, on its comeback from record lows at year-end, the dollar made strides against the major currencies ranging from 4% to 12% but lost over 5% to the Canadian dollar.

In July, the dollar took a hefty jump in the foreign exchange markets. Propelling the dollar were May trade data adding to the trend of improvement in the trade deficit and expectations that central banks had agreed to a higher trading range for the dollar. Although the U.S. stock market was stalled in July, foreign investors remained net purchasers of U.S. equities. Preliminary Treasury data indicate foreign investors made net purchases of $824 million in July, a pickup from net purchases of $339 million in June. Preliminary and confidential SIA data indicate foreign investors were most likely net buyers of U.S. equities in August also. At this pace, while foreign investors are viewing investment in U.S. equities more positively, it is clear that foreign net purchases will not even approach the level of recent years.



Foreign Activity in U.S. Equities

Gross Activity

Foreign gross activity in U.S. equities in the second quarter remained at a subdued pace, $96.8 billion as compared with a 1987 average quarterly clip of $120.6 billion. On a quarterly basis, only European investors reduced gross transactions from the first quarter, 7%, while investors from the other major regions increased activity modestly. At $192.1 billion for the first half of the year, gross transactions trail first-half 1987 activity of about $222.8 billion by 14%. However, with the value of share activity on the NYSE down by about 22%, it appears that the foreign sector has fallen off less than the domestic sectors of the market.

Net Purchases

After two consecutive quarters of net selling of U.S. equities, totaling about $8.0 billion, foreign investment swung to a positive position. Net purchases of $588 million were made in the second quarter. However, were it not for the continued interest of Japanese investors, foreign investors would have been net sellers overall. The $1.5 billion in net purchases by Japanese investors offset net selling of $637 million of U.S. equities by European investors. Canadian investors were also net purchasers in the second quarter, reverting to net buyers of $171 million after making net sales of $80 million in the first quarter. For the first half of 1988, foreign investors were net sellers of $171 million of U.S. equities, a far cry from net purchases of about $19.0 billion in the first half of 1987.

European Investors

European investors remained wary of U.S. equity investment in the second quarter. However, net selling slowed by 30% to $637 million from $908 million in the first quarter. A decline in the level of net sales by U.K. and French investors and an increase in net purchases by investors in the Belgium-Luxembourg countries accounted for the moderation in net sales by European investors. In the first half of the year, European investors made net sales of $1.5 billion in contrast to net purchases of $7.9 billion in the same period in 1987.

Over the first half of the year, U.K. interest rates traveled the comparative spectrum from high at the beginning of the year to low as interest rates globally were increased. The worldwide uptrend of interest rates took some of the pressure off U.K. policymakers who faced the twin problems of a robust domestic economy and a deteriorating trade position. U.K. policymakers were reportedly unhappy with the mix of low interest rates, which were inappropriate given the strength of the U.K. economy, and a high exchange rate which damaged U.K.

TABLE I

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($ Millions)

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Germany	2,795	201	2,831	2
Netherlands	2,050	(236)	1,388	(244)
Switzerland	9,103	(399)	8,984	(468)
United Kingdom	19,681	(599)	18,097	(137)
Canada	7,618	(80)	8,733	171
Latin America & Caribbean	8,971	217	9,634	32
Bermuda	1,677	(9)	1,795	31
Netherlands Antilles	2,822	77	3,244	73
Asia	35,542	(130)	37,807	1,063
Hong Kong	1,975	(180)	1,796	(40)
Japan	28,936	1,072	31,320	1,544
"Other Asia"*	3,597	(933)	3,340	(463)
Total All Countries	$95,358	$(759)	$96,758	$588

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

1/ Total revised.

competitiveness.[1/] Hence, U.K. authorities took advantage of the opportunity to increase interest rates in the second quarter. Although the U.K. stock market slightly outperformed the U.S. market, the pound gave up 4% to the dollar. U.K. investors cut back net sales of U.S. equities to $137 million from $599 million in the first quarter.

After a weak first-quarter start, the French stock market rallied in the second quarter. Propelling the rise of the stock market were two successive cuts in French interest rates

1/ Foreign Exchange Market Trends, Irving Trust, 6/10/88.

and the return to power of the French Socialist party. Although the interest rate cuts were eventually reversed as French resistance gave in to the worldwide trend of higher rates, prospects for growth in 1988 got a sharp boost from an unexpected surge in business investment. French investors remained net sellers of U.S. equities in the second quarter, reducing sales to $33 million from $132 million in the first quarter.

Coinciding with record long-term capital outflows, German investors were the only major European investors making net purchases of U.S. equities in the first quarter, $201 million. The German stock market stayed on an uphill path in the second quarter, relieved that economic growth did not contract as generally expected. A booming export industry helped push the German trade surplus to a record in the first six months of the year. Nevertheless, the dollar's advance on the mark presented policymakers with the dilemma of raising interest rates to defend the mark at the risk of stunting export growth. Although strong capital outflows continued, German investors sought other markets in the second quarter, making net purchases of only $2 million of U.S. equities.

Swiss investors stepped up net sales of U.S. equities by 17% in the second quarter to $468 million from $399 million in the first quarter. Both stock market and currency considerations could have prompted Swiss investors to quicken divestitures. The Swiss market, viewed as undervalued by as much as 20%, rose slightly faster than the U.S. market in the first and second quarters. And, although the Swiss franc suffered the sharpest depreciation of the major foreign currencies, 12%, against the dollar, Swiss investors were seeking other markets for equity investment.

Canadian Investors

It did not take long for Canadian investors to return to the U.S. equity market. Net sales of $80 million in the first quarter of 1988 represented the first time these investors had been net sellers since the end of 1985. Canadian interest rates rose over the second quarter, heightening the attractiveness of domestic fixed income investments. At the same time, despite increasing commodity prices and a strong economy, rising interest rates kept a lid on stock market performance. With the Canadian dollar firm against the U.S. dollar and the U.S. stock market moderately outperforming the Canadian market, Canadian investors swung to net purchasers of $171 million of U.S. equities in the second quarter.

Latin American & Caribbean Investors

Investors from this region decreased net purchases of U.S. equities to $32 million from $217 million in the first quarter. Investors located in Bermuda and the Netherlands Antilles made net purchases of $31 million and $73 million,

respectively. Other activity included net purchases of $106 million from investors in the British West Indies and net sales of almost $50 million by investors in Panama as well as Mexico (not shown in Table I).

Asian Investors

Asian investors swung to net buyers of $1.1 billion of U.S. equities from net sellers of $130 million in the first quarter. Net selling by other Asian investors offset Japanese net purchases of $1.1 billion in the first quarter. However, in the second quarter, Japanese investors stepped up their net purchases by 44% to $1.5 billion as other Asian investors reduced their net sales. With the Japanese market taking a breather after skyrocketing in the first quarter and a stable yen/dollar relationship, Japanese investors showed increased interest in the U.S. market.

Indeed, Japanese investors appear to be increasing their presence in foreign markets overall. Based on SIA's Global Equity Analysis Report, Japanese investors' gross activity in foreign equities escalated to $22 billion in July alone, over half the second-quarter total.2/ Moreover, these investors made net purchases of $941 million of foreign stocks in July, compared with net sales of $700 million during the first half of the year.

Foreign Activity in U.S. Corporate Bonds

While continuing to turn a cold shoulder to U.S. equities, foreign investors took advantage of attractive yields and a stable U.S. dollar by buying U.S. corporate bonds. Second-quarter foreign net purchases totaled $6.6 billion, a sharp sprint from first-quarter purchases of $2.3 billion. Over the quarter, yields on U.S. fixed income investments began approaching their highest levels since the last October. The Treasury quarterly refunding, in fact, brought the highest yields in over two years on long-term issues. With escalating yields enhancing the attractiveness of bonds relative to stocks, investors began reconsidering long-term investments. Nevertheless, like U.S. institutional investors whose net purchases of corporate bonds are down 50% in the first half of 1988 from the first half of 1987, foreign investors have also been cautious as compared with last year.3/ Foreign net purchases of $8.9 billion of corporate bonds through the first half of 1988 are 37% lower than net purchases of about $14.2 billion in the same period in 1987.

U.K. and Japanese investors provided the impetus for the increased level of net purchases. Despite some narrowing of

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2/ International Capital Markets Review, SIA, 9/30/88.
3/ Investor Activity Report, SIA.

TABLE II

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	First Quarter 1988		Second Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$12,802	$1,700	$11,099	$4,379
Belgium-Luxembourg	581	(108)	447	116
France	695	71	468	10
Germany	1,059	231	1,094	522
Switzerland	1,044	(59)	951	51
United Kingdom	8,699	1,521	7,151	3,395
Asia	4,737	190	6,326	1,698
Japan	3,813	287	5,510	1,634
"Other Asia"	569	(111)	406	(86)
Total All Countries	$20,554	$2,304	$19,719	$6,583

Source: U.S. Treasury

yield differentials between U.S. and U.K. corporate bonds over the quarter, U.K. investors escalated net purchases to $3.4 billion from $1.5 billion. The spread favoring U.K. bonds over U.S. bonds shrank by about 20 basis points.[4/] However, with the dollar appreciating against the pound, U.S. bonds held increased attraction for U.K. investors. Other European investors followed suit albeit with less enthusiasm.

Japanese investors, who virtually deserted the U.S. corporate bond market after the first quarter of 1987, showed renewed and strong interest. Japanese net purchases jumped to $1.6 billion in the second quarter from $287 million in the first. The steady relationship between the yen and the dollar drew Japanese funds to corporate bonds, as U.S. yields have generally been higher than those available in the Japanese market.

4/ Based on data in World Financial Markets, Morgan Guaranty Trust Company.

TABLE III

NET FOREIGN PURCHASES OF
U.S. TREASURY NOTES AND BONDS
($ Millions)

	Full Year 1987*	First Quarter 1988*	Second Quarter 1988	First Half
Europe	$23,716	$13,670	$2,215	$15,885
Germany	13,330	5,361	(2,585)	2,776
Switzerland	1,917	(427)	689	262
United Kingdom	3,975	4,029	1,667	5,696
Asia	4,488	12,156	4,718	16,874
Japan	868	12,304	3,415	15,719
"Other Asia"	(3,142)	(528)	(299)	(827)
Nonmonetary Int'l & Regional Organizations	(5,302)	(881)	1,971	1,090
Total All Countries	$25,587	$26,707	$12,245	$38,952

Source: U.S. Treasury
* Revised.

Foreign Activity in Treasury Notes & Bonds

Foreign acquisition of U.S. Treasury notes and bonds in the second quarter dropped to $12.2 billion, almost half the exceptional level of the first quarter. With the dollar holding its own in the second quarter, there was little need for the massive central bank intervention efforts that occurred in the first quarter. Indeed, when the dollar became feisty, speculation developed that central banks would act to counter the rise, which seems to be the case in June when central bank activity resulted in net sales of $1.7 billion of Treasuries. Hence, in the second quarter, central bank net purchases receded to $6.4 billion from $20.4 billion in the first quarter.

Foreign private investors (institutions and individuals) reduced net purchases of Treasuries, while paying increased attention to U.S. corporate bonds. Net purchases of $3.9 billion of Treasuries were made in the second quarter, compared with $7.2 billion in the first. However, at $11.0 billion for the first half of 1988, net purchases by private foreign

investors evidenced a new found respect for the safety and liquidity of Treasuries after the stock market crash.

European activity in Treasuries resulted in net purchases of $2.2 billion in the second quarter, a sharp cutback from $13.7 billion in the first quarter. Net sales of $2.6 billion of Treasuries stemmed from Germany, in contrast to net purchases of $5.4 billion in the first quarter. Along with most key currencies, the German mark came under pressure as the dollar advanced. German policymakers were particularly sensitive to a weakening of the mark, as long-term capital outflows were a record net DM50.6 in the first half of 1988 versus net capital inflows of DM18.7 billion in the same period in 1987.[5/] Although the Bundesbank increased interest rates to shore up the mark, many observers pointed to a poor investment climate and a planned withholding tax as prime reasons for the capital outflow. U.K. net purchases of Treasuries dropped by 58% to $1.7 billion in the second quarter from $4.0 billion. In contrast to the German authorities, U.K. officials were concerned with the damage a too strong pound could do to British competitiveness. Several countries not usually active players in the Treasury market were net purchasers. Most notably, Spain acquired $1.4 billion of Treasuries in the second quarter.

The yen was one of the major currencies against which the dollar suffered a devastating slide in 1987. Japanese central bank operations in support of the dollar in the first quarter appear to be massive, as $12.3 billion in net purchases of Treasuries stemmed from Japan. With the dollar/yen relationship vastly improved by the second quarter, the need for central bank action diminished. The $3.4 billion of second-quarter net purchases could also reflect some private Japanese interest in Treasuries, as these investors were also net acquirers of U.S. corporate bonds.

U.S. Activity in Foreign Stocks

Much of the impetus behind U.S. investors' net purchases of foreign stocks in the first quarter came from a scurry to catch the soaring Japanese market. With the Japanese market resting on its laurels in the second quarter and once again subject to talk of "peaking", U.S. investors did a quick turnabout. The departure from the Japanese market and large sales of U.K. stocks swung the U.S. investment foreign position into the negative. U.S. investors sold $1.2 billion of foreign stocks in the second quarter, in contrast to net purchases of $890 million in the first. For the first half of 1988, U.S. investors were net sellers of $292 million of foreign stocks compared with net purchasers of $2.3 billion in the first half of 1987.

5/ Foreign Exchange Market Trends, Irving Trust, 8/5/88.

TABLE IV

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	First Quarter 1988		Second Quarter 1988	
	Gross Activity	Net Purchases[1/]	Gross Activity	Net Purchases
Europe	$17,343	$ 83	$17,273	$(299)
France	816	96	388	162
Germany	1,140	(126)	1,279	91
Netherlands	841	67	865	43
Switzerland	1,218	540	1,235	25
United Kingdom	12,028	(484)	11,319	(551)
Canada	3,273	(73)	2,610	(38)
Asia	13,006	902	12,960	(546)
Japan	11,899	1,013	11,598	(444)
Other	2,043	(22)	2,313	(299)
Total All Countries	$35,665	$890	$35,156	$(1,182)

Source: U.S. Treasury
1 Total revised.

The Japanese market got its first quarter, and to a certain degree second quarter, push from domestic investors as well as foreign investors hunting for "post-crash" bargins. Not that the Japanese market did not have a positive set of economic fundamentals supporting it. The Japanese government had initiated several major programs in 1987 to boost domestic demand. The fruits of these programs began to show up in increasingly robust economic growth -- double-digit for the first quarter -- and was expected to translate into strong corporate profits. However, although the Japanese market hit some record highs, it dropped back before the close of the second quarter. U.S. investors made net sales of $444 million.

U.S. investors also made net sales of European stocks, $299 million in the second quarter compared with net purchases of $83 million in the first. In the first quarter, large sales of $484 million of U.K. stocks were offset by large purchases of Swiss stocks. In the second quarter, however, while large sales of U.K. stocks continued, U.S. investors significantly

reduced net purchases of Swiss stocks, to $25 million from $540 million in the first quarter. The Swiss stock market enjoyed a slow but steady climb in the first half of the year, gaining over 11%. However, as the stock market's climb began to be overshadowed by the sharp depreciation of the franc vis-a-vis the dollar, U.S. investors headed for the sidelines in the second quarter. U.S. investors increased net purchases of French stock by 69% to $162 million in the second quarter from $96 million in the first, as the French market was on its way to becoming one of the five best performing markets in the first half of the year.

In sum, for the first half of 1988, the lingering memory of the crash has kept most investors leery of foreign equity investment. However, with the growth of foreign markets and the benefits of portfolio diversification, investment in non-domestic equities will continue. Indeed, SIA's Global Equity Analysis shows that after making net divestitures of $9.9 billion of non-domestic securities in the fourth quarter, investors in five major countries including the U.S. have made net purchases of almost $2.0 billion of non-domestic equities in the first half of the year. For U.S. pensions funds, with about 3% of their assets currently in international investments, it is projected that about 20% of their assets will be in foreign investments by 2000.[6/]

Carolyn Hildebrandt
Assistant Vice President &
Director of Macroeconomic
Studies

6/ "Global assets will surge," Pensions and Investment Age, 7/11/88.